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Foreign Direct Investment in Food Retailing: The Case of the People's Republic of China

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I, Amelia Yuen Shan AU-YEUNG, declare that this thesis has been composed by myself, the work is my own and it has not been submitted for any other degree or professional qualification.

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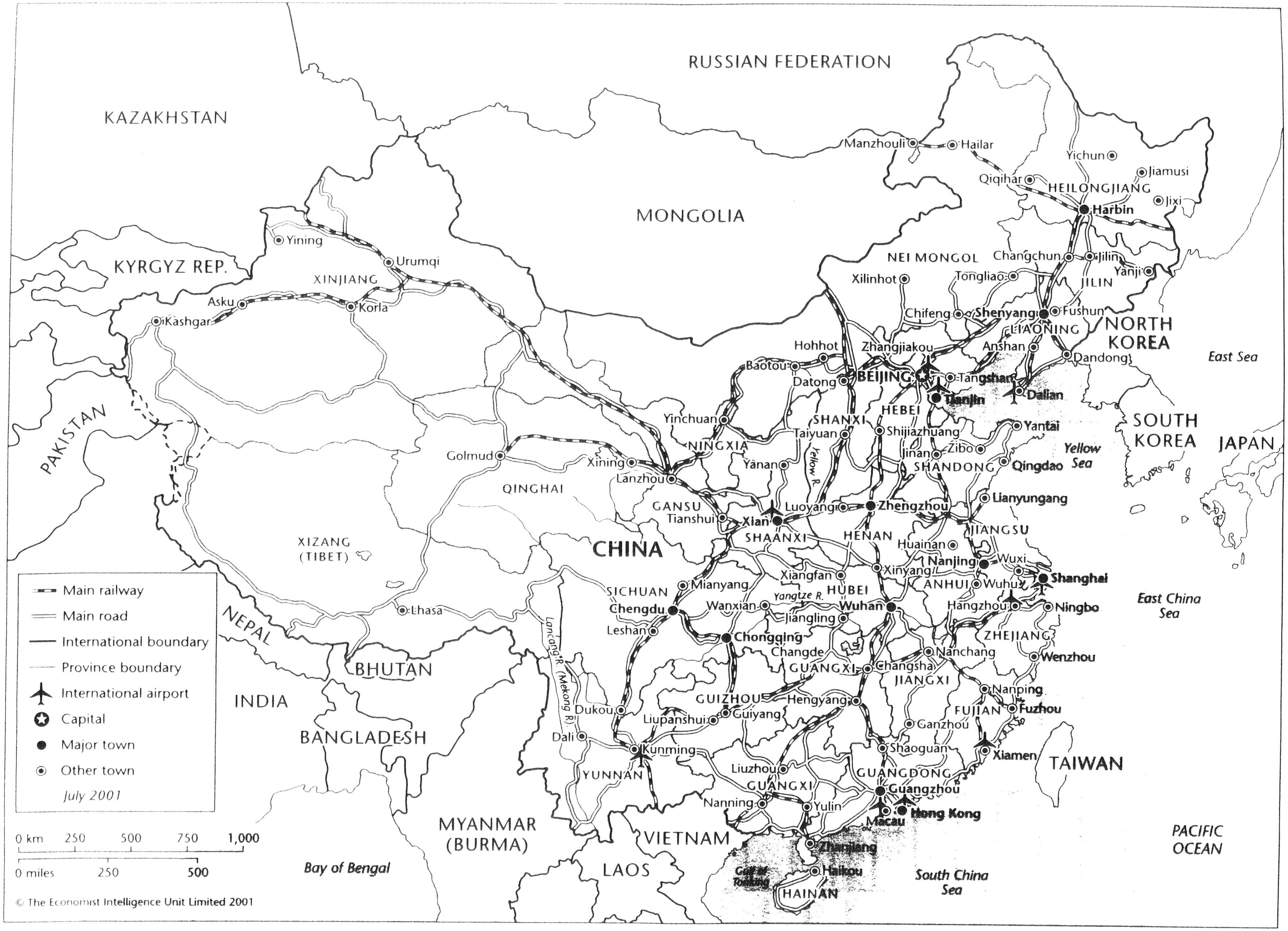
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Thesis Abstract

Foreign direct investment (FDI) in food retailing has generated a considerable amount of attention in both the media and the business world throughout the 1990s, with a strong focus on Asian and Central and Eastern European countries. Among these countries, China is a key player and a nation that no international retailers can afford to ignore due to its population size of 1.2 billion and its rapid economic development. Food retailers from different parts of the world have been keen to use their modern retail concepts and technology to seek expansion opportunities in China. Consequently, two important questions emerge: What does the process of FDI in food retailing entail? Is the retail and distribution market in China easily entered? Regarding the first question, substantial research effort has been vested in this topic. However, a conceptual framework that incorporates the whole scope and complexity of the process is still lacking. For the second question, a prudent scrutiny reveals that foreign food retailers are confronted with a lot of complications due to the legacy of the previous command economy and the unique Chinese social and business structure.

The thesis develops an analytical model in which critical variables, and their logical relationships, are used to analyse and explain the process of FDI of food retailers in the contemporary era, using China as the domain for the empirical work. Methodologically, the study adopts a qualitative approach using case studies with thirteen foreign food retailers in China. The research focuses on three main areas: long-term strategic objectives behind retail international expansion, market entry issues, and retail operational issues.

Firstly, the long-term strategic objectives that underlie retailers' undertaking of foreign direct investment are investigated. Evidence shows that the prevailing concept of reactive retail internationalisation and the tenet of psychic distance do not fully reflect the reality of retail internationalisation.

Secondly, three issues related to market entry are explored. The first issue is the legal and regulatory infrastructures that foreign retailers face when entering China. The second issue is the selection of Chinese partners, managing partner relationships and the share of managerial control. The third issue is the technical and political procedures of site selection and store development. The empirical work reveals that the lack of a systematic and well-developed legal system complicates the process of foreign direct investment and having a Chinese partner who possesses the appropriate *guanxi* network alleviates the problem. Furthermore, the exercise of dominant control over operational and managerial issues is practised by the foreign retailers in their joint ventures. Significant conflicts between partners appear not to exist under such an arrangement. On the other hand, political procedures of site selection and store development are found to be onerous. In terms of technical procedures, respondents reported that the methods that are being used in developed countries are not entirely applicable in China.

The third area on which the research focuses is operational issues that foreign food retailers confront in the host countries. These include supply chain management; adjustment and adaptation; and development of human resources. Findings suggest that there are two types of retail know-how: core and peripheral. No changes to core elements should be made in the overseas operation so that the uniqueness of the individual retailer is preserved. Adjustments, however, have to be made to peripheral elements in order to match particularities of local consumer demand. A learning-oriented culture within a retail organisation is found to be an important underlying element that contributes significantly towards successful retail internationalisation.

Taking a holistic perspective, the foreign direct investment behaviour in the retailing sector and the manufacturing sector, from which the prevailing foreign direct investment theories were developed, appear to be very different. The foreign direct investment behaviour of retailers seems to be better explained and understood within a framework that emphasises market power seeking, stresses the dynamics of different elements that constitute retail know-how, and underscores the notion of knowledge accumulation and utilisation.

Acknowledgement

There are many people I would like to thank. Without them, completion of this doctoral thesis would be impossible. The first two persons to whom I am indebted are my two supervisors, Professor John Henley and Professor John Dawson. They have been very instrumental in my intellectual development throughout the doctoral research. They have also been very supportive and encouraging for all these years. Professor Ronald Savitt is another person to whom I owe much gratitude for the time and feedback he has given me regarding my research. Discussion with him has always been enjoyable and inspirational.

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For Mum and Dad, with all my love

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Chapter 1
Introduction

As individual companies became financially successful in their respective countries, they began looking for opportunities for growth and expansion outside of their domain. The idea soon evolved that this could be achieved by duplicating their proven and winning formula in another country. Consequently, the term 'foreign direct investment' (FDI) was coined and refers to companies that attempt to expand their businesses internationally by setting a presence abroad. However, it was discovered and became increasingly apparent that there are many complexities attached to such business ventures. The thesis focuses on the case of FDI with regards to international retailing and attempts to address some of these issues in detail.

1.1 Deficiencies of the Existing Theories

The 1990s are an important historical point in the development of international retailing. This period witnessed a predominant shift towards foreign direct investment[1], including both organic expansion and joint ventures, in retail internationalisation activities (Myers, 1996). Moreover, there was a significant intensification of retail concentration in Europe. Furthermore, the mergers and acquisition between some powerful retailers, such as those between Carrefour and Promodes, and between Wal-Mart and Asda, have attracted tremendous attention to the speculation of the future landscape of retailing on a world scale. In addition, the economic transition of many countries in Eastern and Central Europe and Asia, especially the People's Republic of China, has catalysed the entrance of many international retailers into these countries. These phenomena have brought retail internationalisation into a new arena.

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[1] According to Hill (1997), foreign direct investment occurs when a firm invests directly in facilities to produce or/and market a product in a foreign country. This is an international business textbook definition

In terms of academic research, Hollander (1970) is considered the pioneer in detailed research on internationalisation of retailing and his work is regarded as a starting point for the study of the topic (Pellegrini, 1991; Brown and Burt, 1992a; Brown and Burt, 1992b; Burt, 1995). Then, a considerable amount of academic research was dedicated to the international retail activities on both sides of the Atlantic when European and North American retailers were very active in transatlantic investments (e.g. Dawson, 1976, 1978, 1979, 1982a, 1982b; Waldham, 1978; Ball, 1980; Goldman, 1981; Martenson, 1981; Siegle and Handy, 1981; Truitt, 1984; White, 1984 in Akehurst and Alexander, 1995; Hallsworth, 1990; Hamill and Crosbie, 1990; Exstein and Weitzman, 1991; Clarke *at al.*, 1997; Sternquist, 1997a; Alexander 1999).

In the late 1980s and 1990s, studies on international retailing in transitional economies started to emerge (e.g. Fulop, 1991; Loker *et al.*, 1994; Drtina, 1995; Good and Huddleston, 1995; Myers and Alexander, 1997; Sellaro, Maskulka and Burns, 1997; Dawson and Henley, 1998) as retailers from Europe and America gradually entered the transitional economies in Central and Eastern Europe, which was triggered by the break down of communist power and the economic transformation in that region. The same period also saw a surge in research on the topic in Asia (e.g. Ho and Sin, 1987; Davies, 1993a; Davies, 1993b; Davies and Jones, 1993; Sternquist and Runyan, 1993; Cheung, 1994, 1996; Hise *et al.* 1995; Sparks, 1995; Treadgold, 1995; Yang and Keung, 1996; Goldman, 2001).

The main themes of the literature on retail internationalisation include: reasons and motivations (e.g. Salmon and Tordjman, 1989; Alexander, 1990; Robinson and Clarke-Hill, 1990; Treadgold, 1990; Williams, 1992a, 1992b; Quinn, 1999); the geographical flows of investment (e.g. Kacker, 1985, 1990; Hamill and Crosbie, 1990; Burt, 1993); transfer of retail know-how from developed to developing countries (e.g. Goldman, 1981; Kaynak, 1985; Tuncalp and Yavas, 1990; Goldman, 2001); strategies and

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of foreign direct investment. For the purpose of this thesis, retail foreign direct investment takes place when a retailer invests directly in and manages retail store operations in a foreign country.

processes through which internationalisation occurs (e.g. Hollander, 1970; Waldman, 1978; Kacker, 1985; Simpson and Thorpe, 1995; Clarke and Rimmer, 1997; Dawson, 1999a: Dawson, 1999b); the timing of investment (e.g. Treadgold, 1990, 1991; Burt, 1991, 1995) and case histories of individual firms (e.g. Laulajainen, 1991; Treadgold, 1991; Sparks, 1995; Arnold, 1999); and methods and typologies of investment (e.g. Treadgold, 1988; Dawson, 1994b; Bailey, Clarke-Hill and Robinson, 1995; Helfferich, Hinfelaar and Kasper, 1997).

There is no question that the amount of academic work conducted on the topic of retail internationalisation is substantial. The volume of literature has increased dramatically, particularly over the last two decades. Nevertheless, much more research effort is needed to necessitate a complete conceptual understanding and comprehensive coverage of the process of retail internationalisation (Alexander and Doherty, 2000). More importantly, effort should be directed towards obtaining an in-depth and holistic explanation that embraces the dynamic behavioural and organisational elements, which play an important part in the retail internationalisation process (Dawson, 2000a).

Furthermore, the literature developed by scholars in the retailing field has not yet occupied a comfortable position in the wider academic arena of international business studies (Alexander and Doherty, 2000; Alexander and Myers, 2000). Foreign direct investment is a major area in the study of international business. However, the dominating foreign direct investment theories are built on research in the manufacturing sector (e.g. MacDougall, 1960; Hymer, 1976; Kindleberger, 1969 in Hooley, Cox, Shipley, Fahy, Beracs and Kolos, 1996; Buckley and Casson, 1976; Dunning, 1977, 1981, 1993 and 1995; Casson, 1979; Rugman, 1981; Beamish and Banks, 1987; and Buckley, 1988; Denekamp, 1995; Buckley and Casson, 1998). There are several attempts by scholars in the field of international business to extend the theories to include consideration of the service sector. Nonetheless, most of these attempts tend to maintain that the existing theories are largely readily applicable to the service sector (e.g. United Nation, 1993; Dunning and Kundu, 1995). There are also international retail studies that tried to integrate and encompass the traditional international business theories. Regardless of other industries in the service sector, the retail sector is significantly different from the manufacturing sector in terms of industry structure and many other characteristics, which are discussed in Chapter 2. These differences have not been taken into serious consideration in those studies. Their approaches undermine the idiosyncrasies of the retail process (Alexander and Myers, 2000). In fact, several authors in the retailing discipline (e.g Dawson (1994b), Alexander and Lockwood (1996), Burt and Carralero-Encinas (2000), and Alexander and Myers (2000)) have pointed out that conceptual frameworks developed in non-retail or non-service environment are unable to explain the process of retail internationalisation. This shortcoming has to be rectified because the combination of an unprecedented global economic and political restructuring, the significant growth in power and impact of some leading world retailers and the increasing importance of foreign direct investment activities in the retail sector will open up a new chapter in the retail development history. A framework of foreign direct investment for the retail sector that can capture the essence of retail internationalisation in the 21^{st} century is needed.

1.2 Research Objective

Based on the deficiencies of the existing theories discussed above, the objective of the present doctoral research is to establish an analytical model in which critical variables, and their logical relationships, are used to analyse and explain the process of foreign direct investment of food retailers in the contemporary era.

In order to achieve the research objective, the study focuses on three questions:

- What are the long-term strategic objectives behind retail internationalisation?
- How do retailers handle market entry issues that they face when undertaking foreign direct investment in a host country?
- How do retailers transfer retail expertise from their home country to a host country?

The first question seeks to explain the 'why' and 'where' part of foreign direct investment of retailers. The long term objectives that drive the overseas expansion of retailers is examined and the main factors that retailers consider when choosing a host country are investigated. The second question aims to uncover the 'how' part of foreign direct investment that is related to market entry. Issues that are investigated under this question include how the legal and regulatory infrastructure of a host country affects the market entry of a retailer and how partners and sites are selected in the host country. The third question endeavours to understand the 'what' and 'how' part of foreign direct investment that is associated with retail operation. The process of retail expertise transfer is studied under this question. The elements of retail expertise that are transferred directly and that are transferred with adjustments are also scrutinised.

1.3 The People's Republic of China (PRC)

The People's Republic of China (PRC) is the largest and the fastest growing country among those that are undergoing economic and political reforms. The country has opened up new territories for international retailers. In this thesis, the word 'China' refers the People's Republic of China excluding Hong Kong Special Administrative Region and Macao Special Administrative Region.

There have been many economic and social changes in China since the introduction of the 'open-door' policy in 1979. Between 1978 and 1996, its annual average growth rate of GDP maintained at a level of about ten percent. Although 1997 saw a slow-down of the economy, China's GDP growth has remained above seven percent since then[2]. In December 2001, the Chinese government officials announced that its GDP in that year was more than US$ 1.15 trillion, representing a 7.4% growth[3]. China is the second

[2] See Appendix 1.1
[3] Source: People's Daily Online. 2001. "China's Economy to Grow 7.4 Percent, GDP to Top US$1.15 Trillion This Year." *People's Daily Online.* 21 December. [Online] Available from: URL: http://english.peopledaily.com.cn/200112/21/eng20011221_87212.shtml [Accessed 16 February 2002].

largest economy in the world, after United States, in terms of Purchasing Power Parity in 2000[4]. Total foreign direct investment inflow between January and October 2001 is US$ 55.2 billion[5]. In economic terms, China is making remarkable progress with a promising future development.

Looking at the retail environment in China, the country has become a popular target for retail internationalisation since the partial opening of its retail sector to foreign direct investment in 1992 for demographic reasons. One fifth of the world population, which is 1.2 billion, resides in China. Although the affluent population only accounts for a small percentage of the whole, being an emerging market China provides opportunities that are attractive to foreign investors. The retail market in China is largely untapped. There is relatively little competition. Simultaneously, the average urban disposable income has been increasing. When these factors combined together, China presents tremendous opportunities to foreign retailers.

In addition, China's successful entry into the World Trade Organisation in December 2001 has brought along a further liberalisation on foreign direct investment policies in retailing. For example, foreign department and chain stores will be allowed to run wholly owned networks in China[6]. This further increases the attractiveness of China as a market for foreign food retailers.

As indicated by the above factors, China is very important to the contemporary development of international retailing. Therefore, a thorough understanding of the retail development and environment in China is necessary. On the other hand, China also serves as an appropriate environment for the investigation of the process of retail internationalisation because of the following reason: the Chinese retail and distribution

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[4] Source: World Bank. 2001b. *World Development Indicators database.* 16 July. [Online] Available from: URL: http://www.worldbank.org/data/databytopic/GDP_PPP.pdf [Accessed 16 February 2002].

[5] Source: People's Daily Online. 2001. "China's Economy to Grow 7.4 Percent, GDP to Top US$1.15 Trillion This Year." *People's Daily Online.* 21 December. [Online] Available from: URL: http://english.peopledaily.com.cn/200112/21/eng20011221_87212.shtml [Accessed 16 February 2002].

[6] The changes in foreign direct investment policies in the retail sector are discussed in detail in Chapter 6.

market has been closed to the outside world from 1949 to 1992 and therefore the retail and distribution industry was underdeveloped. As a result, not much knowledge about the market was available to the outside world. Furthermore, the socio-economic, cultural, technological and regulatory environment in China differs significantly from that in most developed countries. Consequently, foreign retailers are facing and have to overcome many complicated issues when they conduct foreign direct investment in China. Under this situation, the dynamic factors that are critical to the internationalisation process of retailers will become even more prominent and can be observed more easily. Subsequently, China provides a suitable background against which the study of the process of retail foreign direct investment is carried out.

Based on its importance to the development of international retailing in the 21st century and its suitability to the study of foreign direct investment in retailing, the present research is undertaken in China.

1.4 Scope of Study

The present study focuses on four main cities in China: Beijing, Shanghai, Guangzhou and Shenzhen[7]. The fieldwork was carried out in the period between April 1999 and September 1999 and the last update on certain secondary information was conducted in October 2001. Food retail sector is the subject of study. In this thesis, 'retailing' refers to the sale of goods and services to the ultimate consumers for personal, family or household use. Nevertheless, the readers should note that foreign cash and carry operators in China do not operate strictly as wholesalers, because foreign direct investment in wholesaling was forbidden by Chinese law prior to China's entry to WTO, and hence are considered retailers in this research. For the purpose of the present research, food retailing is defined as main-line grocery retailing. Therefore, this study excludes the international activities of retailers operating in speciality food sectors such as restaurants, confectionery, butchery, bakery, gourmet food, health food, frozen food

[7] Rationales for choosing these four places are discussed in the Chapter 4.

and fast food. Furthermore, as this study concentrates on the examination of foreign direct investment behaviour of food retailers at the strategic level, research on marketing-related issues and Chinese consumers' food shopping behaviour is outside the scope of the study. The financial aspect of retail foreign direct investment is also beyond the scope of the present research and consequently is not investigated.

1.5 Structure of the thesis

This thesis starts with a review of the traditional foreign direct investment theories and an investigation of the differences in nature between the manufacturing sector and the retailing sector. The chapter that follows presents an overview of the characteristics of an economy in transition. Next, there is a discussion of the methodology adopted for the present research. The following three chapters present and analyse the data obtained from the author's fieldwork and discuss their implications in the light of the existing literature. The first of these three chapters evaluates the motivation and process behind retail internationalisation and the reasons for foreign retailers investing in China. The second of these three chapters explores the legal and regulatory infrastructure for foreign direct investment in retailing in China, the joint venture partners and their share of managerial control, the store location decisions and the legal and technical issues that relate to retail store development. The last of these three chapters scrutinises the process of transfer and adaptation of three main areas of retail expertise: supply chain management, retail format and formula and a learning-oriented culture. The final chapter of the thesis concludes with a suggested framework for the understanding and explanation of retail foreign direct investment in the contemporary era. Suggestions made for future research are also included.

Chapter 2
Theoretical Underpinnings

A significant volume of literature has been developed that seeks to provide an explanation for the extent and pattern of foreign direct investment (FDI). In the past few decades, an enormous amount of research effort has been invested in the internationalisation of firms in the manufacturing sector (MacDougall, 1960; Hymer, 1976; Kindleberger, 1969 in Hooley, Cox, Shipley, Fahy, Beracs and Kolos, 1996; Bucley and Casson, 1976; Dunning, 1977, 1981, 1993, 1995; Casson, 1979; Rugman, 1981; Beamish and Banks, 1987; Buckley, 1988). Correspondingly, scholars from the discipline of retailing have also started to conduct studies on retail internationalisation since the 1970s. However, as claimed by Burt (1991) and Pellegrini (1991), most of the studies that have been done on retail internationalisation tend to treat the subject as an isolated topic and there has hardly been any integration between this subject and the wider body of literature on international business. Consequently, this chapter reviews in detail the general theories on foreign direct investment and evaluates their applicability to the retailing sector. An outline including the factors that appear to be pertinent to the process of foreign direct investment in retailing is also presented at the end of this chapter. The outline serves as a blueprint on which the present research is built.

2.1 Theories on Foreign Direct Investment

The theoretical foundation of FDI is rather fragmented (Braunerhjelm, 1996). A review of literature will discover that studies on foreign direct investment can be divided into two categories. The first category comprises theories that come from the economics background. These theories include internalisation theory, market power approach, trade theory, product cycle model, eclectic paradigm and the theory on mode of market. The second category contains theories that come from other disciplines, such as organisational behaviour and strategic management. Network approach and process model is two examples of such theories. While sharing a common focus on FDI, these strands ask different questions. Scholars also differ in their choice of unit of analysis. All these approaches are discussed below.

2.1.1 Theories Developed from the Discipline of Economics

The earliest work on foreign direct investment originated mainly from the discipline of economics. Theories developed by economists can be divided into two groups. Transaction cost theory/Internalisation theory and market power approach take a microeconomic perspective, while trade theory and international product cycle model adopt a macroeconomic approach. These theories, together, contribute significantly to the study of FDI.

2.1.1.1 Transaction Cost Theory/ Internalisation Theory

Transaction cost theory and internalisation theory were developed independently in two trans-Atlantic locations at different time (Rugman, 1986). The former was originated from the work of Coase (1937) and that of Williamson (1975), which has later been extended from a mainly domestic U.S. institutional context to an international dimension in several papers by Williamson's former students, David Teece (for instance, 1981, 1983, 1985) and Hennart (1982). Buckley and Casson (1976) and Rugman (1981) advocated the latter. In fact, internalisation theory is based on the analysis of transaction cost. The two approaches share very similar underlying logic and analysis. Hence, they could be considered as one school of thought (Rugman, 1986; Cantwell, 1991; Hennart, 1991). Therefore, the two theories are also discussed together in this section.

Internalisation theory aims to explain why the cross-border transactions of intermediate products are organised by hierarchies rather than determined by market forces. The main focus of this theory is on the economics of vertical and horizontal integration, with emphasis on the advantage to the individual firm instead of the industry of keeping decisions internal. Its fundamental hypothesis is that multinational hierarchies represent an alternative mechanism for arranging value-added activities across national boundaries to that of the market. Furthermore, firms are likely to engage in FDI whenever they perceive that the net benefits of their joint ownership of domestic and foreign activities, and the transactions arising from them, are likely to outweigh those offered by external trading relationships. Given a particular distribution of factor endowments, internalisation theory predicts that MNE activity will be positively related to the costs of organising cross-border markets in intermediate products.

The basic argument of internalisation theory is derived from the assertion of the existence of transactional market imperfection, which reflects the inability of the market to organise transactions in an optimal way and the internalisation advantage is thought to arise from the existence of such imperfect markets.

According to Coase (1937), there is a cost of using the price mechanism. The most apparent cost of organising economic activities through the market is that of discovering what the relevant prices are. The costs of negotiating and settling a separate contract for each exchange transaction that takes place on a market must also be taken into account. When the contracting mechanism breaks down, the market is unable to correctly value and protect firm-specific advantages that are intangible in nature. Williamson (1975, 1981) went further and identified three key transaction costs. They are the costs of informing traders (information costs), the costs of reducing bargaining as to the terms of trade (bargaining costs) and the costs of enforcing the terms of trade (enforcement costs). Because of the existence of these costs, buyers and sellers do not have the symmetry of information about the consequences of the transactions that they are undertaking. Such cognitive deficiencies lead to bounded rationality, opportunism, adverse selection, moral hazard and information impactedness (Williamson, 1983). Under such conditions, it is beneficial to replace market contracting with hierarchical organisations. In an international context, these ideas are extended and applied to multinational enterprises (MNEs). The MNE is itself a governance structure, which can be modelled as a set of efficient outcomes subject to contingencies.

There is another reason for transactional market failure. The market cannot take account of the benefits and costs that arise because of a particular transaction, but which are external to that transaction (Dunning, 1993). When there is joint supply of products, or when products are derived from a common input or set of inputs, this may serve as a good reason for different stages of the value-added chain, or the same stage of different value-added chains, to be co-ordinated under the same governance. Additional advantages of common ownership such as those that exploit the imperfections of international capital and exchange markets and different national fiscal policies could also result from cross-border transactions.

On the other hand, when the demand for a particular product, while infinitely elastic, is insufficiently large to enable the producing firms fully to capture the economies of size, scope and geographical diversification, transactional market failure also arises. In such case, there is an inevitable trade-off between the overall costs of a set of value-added activities and the opportunities they offer for synergistic economies (Galbraith and Kay, 1986 in Dunning, 1993).

It is these market deficiencies which may cause enterprises, whether they are uninational or multinational, to diversify their value-adding activities and in so doing realign the ownership and organisation of these activities.

To summarise, internalisation theory focuses on the transaction, with the efficient management of transactions, which is the ability to minimise transaction costs, being the source of the firm's competitiveness. However, this concern on transaction cost minimisation, together with its assumption on opportunistic behaviour of human beings, has been extensively criticised (Ghoshal and Moran, 1996). As a result, many alternative theories on multinational enterprises have evolved. Monopolistic competition theory and competitive advantage theory, which are discussed in the next section, are two examples.

In addition to the widely claimed shortcomings, the applicability of internalisation theory to the multinational activities of retailers is also limited for the following reason: unlike the manufacturing industry, retail service is a non-tradable service. There does not exist the option of organising its cross-border activities through the market mechanism when a multinational firm chooses to serve a foreign market. Therefore, the transaction cost analysis is irrelevant to the explanation on the emergence of multinational retailers. Nevertheless, as transaction cost theory/internalisation theory focuses on the economics of vertical and horizontal integration, it is still pertinent to the examination of the structure of distribution channel, which is an important constituent of the study on retailing. Nonetheless, the distribution channel is not the focus of the present study and therefore will not be discussed in further details.

2.1.1.2 Market Power Approach and Competitive Advantage

Market power FDI theories address the question of why firms of one nationality are more capable to penetrate foreign markets than indigenous firms located in those markets. They also deal with the question of why they wish to control value-added activities outside their national boundaries. They treat FDI as a means by which firms extend their control (Hymer, 1976; Caves, 1971) and market power (Cantell, 1991). On the contrary to transaction cost/internalisation theory, whose basis is the transactional market imperfection, the basis of these theories is the structural market imperfection theories (the differences between the two theories are discussed in more details later). Structural market failure is believed to give rise to monopoly rents as a result of the presence of entry barriers which the constituent firms may seek to erect or increase by a variety of means, including the acquisition of competitors (Hymer, 1976).

Hymer was the progenitor of this type of explanation of foreign production (Dunning, 1993). He perceives firms as a means by which producers increase the extent of their market power. According to Lall,

> "Market power...may... be simply understood as the ability of particular firms, acting singly or in collusion, to dominate their respective markets (and so earn higher profits), to be more secure, or even to be less efficient than in a situation with more effective competition.... The concept may, of course, be applied to buyers (monopsonists) as well as sellers" (1976: 1343 in Cantwell, 1991:21).

This definition of market power purports that in the early stages of growth, firms constantly increase their domestic market share by means of merger and capacity extension and that profit rises as industrial concentration rises. Nevertheless, there comes a point at which it becomes very difficult to further increase concentration in the domestic market when few major firms remain. At this stage, firms will invest their profits earned from the high degree of monopoly power at home in foreign operations. This, in turn, will lead to a similar process of increased concentration in foreign markets (Cantwell, 1991).

By applying an industrial organisation approach to the theory of foreign production, Hymer (1976, 1968 in Dunning, 1993) argues that a firm must possess some kind of innovatory, cost, financial or marketing advantages. These advantages must be specific to their ownership and be sufficient to outweigh the disadvantages they faced in competing with indigenous firms in the country of production. He lists factor cost advantages, knowledge advantages, marketing advantages and product differentiation as the ways in which the MNE secures an advantage. The existence of these advantages implies the presence of some kind of structural market failure. Moreover, in extending this analysis to explain the cross-border activity of firms, he further argues that such firms had to possess some kind of proprietary or monopolistic advantage.

The existence of structural imperfections, which are Bain-type advantages[1] to enhance the asset power of the MNE, is a main element that differentiates the market power approach from the internalisation school, which bases its argument on the presence of transactional market failure. According to Dunning and Rugman (1985), in spite of the fact that the MNE experiences an ownership advantage that appears to be similar to a Bain-type asset power advantage once internalisation has been undertaken, it is important to distinguish the source of the advantage. If an exogenous market imperfection induces the MNE to organise an internal market to substitute for an non-existing external market (for example, in the pricing of knowledge) or to replace more expensive modes of transactions, then the process of internalisation improves efficiency. No rents would be expected or realised for the MNE when it is exploiting transaction cost power. On the contrary, under the

[1] See Appendix 2.1 for further explanation of Bain-type advantages.

assumption of existence of structural imperfection, Hymer's market power approach maintains that MNE has the power to close markets by using one or more of the Bain-type advantages to generate economic rents.

Hymer's work on the market power approach to FDI set a platform for the contemporary ideas such as strategic alliances, co-operative ventures, information sharing, and even market sharing as a consequence of supra MNE collusion (Horaguchi and Toyne, 1990). He believes that in order to fully understand the phenomenon and behaviour of MNCs, it is necessary to take into account managerial resources at a specific point in time, and over time. In fact, the various expressions (which are used interchangeably in this paper) used today such as "managerial resources" by Penrose (1956, 1959), "intangible assets" by Caves (1982), "firm-specific advantages" by Dunning (1979) and "competitive advantage" by Porter (1980, 1985, 1986) cover virtually the same concepts as "advantages of a firm" by Hymer (1976). Porter (1980) and others have asserted that the main theme of strategic management and business strategy is to identify entry and exit barriers, and then operate generic strategies based upon price competition, product differentiation, or the seeking of market niches of product lines of the firm. Clearly, these constructs are direct analogous to Hymer's Bain-type advantages (Dunning and Rugman, 1985; Buckley, 1990; Grosse and Behrman, 1992). Nevertheless, Grosse and Behrman (1992) claim that additional insights are offered by strategic management perspective as it focuses on inter-firm rivalry and intra-firm human resource management.

As the discussion of competitive advantage, which is pertinent to the present study on FDI activities of retailers, involves concepts from organisational theory and strategic management, it is further investigated in section 2.1.2.

2.1.1.3 Trade Theory

The classical theory of international trade, which is known as Heckscher-Ohlin model, focuses on patterns of production and export. This model assumes perfect factor and product markets, absence of factor reversals, factor immobility, zero transport costs, internationally identical production functions and production factors, and constant returns to scale. Export marketing costs, by implication, do not exist. Information about technology such as product and process specifications is assumed to be freely and instantly available to all. Therefore, production functions are virtually identical everywhere (Hirsch, 1976). In other words, at the root of this traditional model of international trade is the assumption of perfect competition. However, it is this assumption of perfect competition that has encumbered the establishment of a linkage between foreign direct investment and the classical trade theory, because imperfect competition is at the heart of all the theories of multinational firm (Krugman, 1983). Foreign direct investment is believed to be a response to market imperfection, no matter whether this is transactional or structural. It only takes place in a world that recognises firm-specific revenue-producing factors and information, communication and transaction costs that increase with economic distance. This means that a model of imperfect competition is a prerequisite to a formal model of multinational enterprise.

In response to the gap between traditional trade theory and multinational theory, attempts have been made by a number of authors to introduce imperfect competition into trade theory since the 1980s. For instance, Helpman (1984) develops a general equilibrium model of international trade, with some of the characteristics of FDI, to assist the explanation on patterns of trade under conditions of MNE activities. The FDI features present are firm-specific advantaes, which is treated as inputs that can service product lines in multi-plant locations. His model incorporates the concept of product differentiation, monopolistic competition and scale economies. Caves (1971), Batra and Ramachandran (1980), Jones and Dei (1983) and Markusen (1995) have also endeavoured to capture the intangible firm-specific advantages of MNEs as a sector-specific capital. In a similar vein, Krugman (1983) borrowed the theory of trade in differentiated product and theory of vertical integration to establish a product differentiation model of FDI and a vertical integration model of FDI respectively.

Product Differentiation Model of FDI

The product differentiation model of FDI aims at explaining horizontal multinationals as a response to product differentiation. It assumes that the motivation for trade is the presence of certain fixed costs that incur in the process of product development. This means that once the fixed cost has been incurred, it will not be repeated even if production is conducted in more than one location. The asset acquired by the fixed cost could be production technology, or less easily specified management or marketing know-how. The essence of this model is that the fixed costs are not attached to the location of production. This tenet is pertinent to the context of retailing in that when certain retail know-how, such as a concept, is created, the cost of its creation will not be repeated when the production of retail service is conducted in other locations.

With this assumption, it is obvious that there are two alternatives, export or FDI. At the same time, licensing of products and franchising are ruled out by assumption, because the nature of product differentiation would not be tangible enough to specify in a contract (Caves, 1971). The incentive to produce abroad is to avoid transportation costs. However, there are also some costs of overseas production. This model focuses on the labour cost and assumes that in foreign controlled production, labour is not as productive as it is in domestic controlled production. In other words, extra labour cost arises when the production is undertaken in a foreign country. It is apparent that FDI will be chosen instead of trade in commodities when transportation costs exceed the extra labour costs.

Under the situation of FDI, nothing material is being traded while there is no denying that there is some kind of trade, which benefits both the host and domestic countries, being undertaken. Krugman (1983) proposes that, in an economic sense, this situation could be perceived as if the two countries are trading information. Firms in each country possess different technologies, taking the form of the knowledge of how to produce different products. They can trade this knowledge indirectly through trade in commodities manifesting their specific technological advantages, or they can trade it directly through technology transfer with MNCs.

This serves as an interesting way to look at FDI activities. As mentioned earlier, retailing service is a non-tradable service. However, under this new perspective, the multinational operation of retailers could be perceived as an activity trading their specific knowledge such as superior retail concepts across borders. Furthermore, this model emphasises that it is the possession of technology or knowledge that lays the foundation for FDI. This notion echoes the concept of firm-specific competitive advantages discussed in section 2.1.2.

Vertical Integration Model of FDI

The vertical integration model of FDI aims at explaining the reasons and patterns of vertical multinationals by employing the standard model of vertical integration. It argues that by keeping the price of its raw material down, a monopsonistic firm distorts the production decisions of its foreign suppliers and leads them to underproduction. By undertaking FDI and integrating backward, the firm can eliminate the distortion and appropriate the efficiency gain. This discussion seems to be especially pertinent to those industries that rely heavily on raw materials that their domestic countries do not possess (natural resources are one example of this kind of raw material). In the context of retailing, this discussion of backward integration also appears to be relevant to those retailers with a very specific retail concept and a very specific type of merchandise, such as Disney Store, Benetton and Ikea[2]. On the other hand, in terms of supermarket retailing, merchandise is the analogue to raw materials in the manufacturing industry. It is not common for supermarket retailers to depend heavily on some suppliers in certain countries. Instead, in a global context, the supply side is dominated by a number of multinational manufacturers such as Procter and Gamble, Unilever and Johnson and Johnson. Backward integration of multinational retailers with these manufacturers has not been demonstrated, though it might be plausible to assume that the existence of the latter facilitates the FDI of the former. In China, foreign retailers are required to purchase a certain amount of merchandise from local manufacturers. Moreover, by considering the transportation costs and perishability of fresh foods, foreign food retailers would prefer to purchase from local food producers. However, most local producers in China are not capable of producing quality products, which is a characteristic of a transitional economy.

[2] Some may question that whether those retailers are retailers integrating backward or are in fact manufacturers at the first place integrating forward. As this thesis focuses on FDI of food retailers, this issue will not be dealt with as this is outside the scope of the study.

Therefore, in order to ensure the quality of their merchandise, foreign retailers might choose to involve in giving technical assistance to the indigenous producers. This area has yet to be researched.

Problem with the above Mentioned 'New' Trade Theories

The main problem with the investigated theories above of international trade is that they do not explore the reasons why FDI is preferable to joint ventures, licensing or other non-equity forms of foreign involvement such as franchising (Rugman, 1986). They rule out the choice of licensing by simply assuming that it is a costly modality.

Other Types of Trade Theories

Some of the more progressive trade economists have also contributed to the development of the macro-economic approach to FDI. Caves (1982) and Batra and Hadar (1979) are two examples.

As Caves (1982) argues, the process of FDI involves some net transfer of capital, so models of international capital movements are relevant in analysis of such factor mobility. Factors which change the terms of trade, such as long-term movements in exchange rates, can also affect FDI.

Batra and Hadar (1979) also find that devaluation of the home currency of the MNEs causes it to decrease FDI and expand production at home in order to increase exports. Following the logic of this argument, it is very plausible to believe that devaluation of a foreign market currency will also affect the FDI activities in that country.

As pointed out at the beginning of the thesis, this study does not investigate the financial aspect of FDI and therefore, the applicability of these trade theories to the retailing sector will not be discussed further.

2.1.1.4 International Product Cycle Model

Similar to the trade theories explained in the last section, the international product cycle model also takes a macroeconomic developmental approach. While the starting point of the trade theories is the neo-classical type of trade model, it makes use of the product cycle model, which is a micro-economic concept, to help explain FDI. The international product cycle model moves beyond locational cost concerns to incorporate more micro elements. It argues that FDI is a response by the firms to product and/or technological maturity and to growing demand in foreign markets, which stimulates the entry of indigenous firms.

The international product cycle model was initially proposed by Vernon in 1966. He endeavours to explain the patterns of international trade and FDI in manufactured goods that emerged among non-communist countries during the period after the Second World War. The unit of analysis of this theory is the transnational corporation. By exploring the importance of both product creation and effective marketing for new manufactured goods, a dynamic sequence of domestic production, export, FDI and product abroad is obtained (Grosse and Behrman, 1992). Moreover, emphasis is put on the timing of innovation, the effects of scale economies and the role of ignorance and uncertainty in influencing trade patterns instead of on comparative cost doctrine.

New Products

According to Vernon (1966), the first assumption of this model is that the enterprises in any one of the advanced countries of the world can secure access to scientific knowledge that exists in the physical, chemical and biological sciences. Moreover, they all have the same capacity to comprehend such knowledge.

Nevertheless, the assumption that all firms have equal access to knowledge does not mean that they also have equal probability of the application of the knowledge in the generation of new products. Vernon believes that a firm's consciousness of and responsiveness to opportunity are a function of ease of communication, which in turn is a function of geographical proximity. Therefore, knowledge is not a universal free good. Accordingly, producers in any market are more likely to be aware of the possibility of inventing new products in that market than producers situated elsewhere would be.

In the early stages of introducing a new product, producers are usually confronted with a number of transitional but critical conditions. Nature of design at this stage is always unstandardised in order that further improvement could be made. With this unstandardised nature, producers are exceptionally concerned with the degree of freedom they have in changing inputs. As the nature of these inputs cannot be fixed in advance with assurance, the general need for flexibility in any locational choice must be taken into consideration in calculating the cost. Furthermore, in the early stages, monopoly or a high degree of production differentiation usually exists. As a result, the price elasticity of demand for the output of individual firms is comparatively low. Consequently, small cost differences count less in the calculations of the entrepreneur than they possibly do later on. On the other hand, at this stage, a considerable amount of uncertainty regarding the ultimate dimensions of the market, the efforts of rivals to pre-empt that market, the specifications of the inputs needed for production and the specifications of the products likely to be most successful in the effort remains. Therefore, there is a tremendous need for swift and effective communication on the part of the producer with customers, suppliers and even competitors.

All of these considerations tend to argue for a location in which communication between the market and the firm concerned with the new product is instantaneous and straightforward.

The discussion on the importance of closeness between a firm and its market is relevant to foreign retailing in a transitional economy in the sense that communication between retailers and consumers is very crucial. Geographical proximity between retailers and consumers provides the best and quickest access to knowledge such as consumer income, taste and style, which in turn enables the firms to make prompt adjustment of their services. In China, retail formats such as supermarket and hypermarket, are considerably new concepts. It is of ultimate importance for foreign food retailers to operate in a location at which the interaction between them and their consumers is maximised. For retailers, the choice of location is of two levels. The degree of economic advancement in different cities and provinces in China is different, because the government imposes different economic policies on different places. Habits of inhabitants in different parts of China are also different. Therefore, China cannot be considered as one homogeneous market. Hence, the choice of which cities or provinces in China to launch their operations becomes an important issue and this is the first level of locational choice. Then comes the decision on where in the city or province to open their retail outlets and this is the second level of the question. Unlike manufacturers, retailers have to locate themselves in a place where exposure to consumers is maximised. When retailers first entered China immediately after the partial opening of the retail sector to foreign direct investment, there might have been relatively greater flexibility on the choice of locations because modern formats of retailing, such as hypermarket and cash and carry, did not exist and hence there was very little competition. Nevertheless, as the number of players in the sector increases, the pressure of obtaining the prime sites in each city becomes more crucial. Therefore, the decision on locational choice on both levels is critical to the success of the foreign retailers in China.

Maturing Products

Vernon (1966) claims that as the demand for a product increases, a certain degree of standardisation will take place. Simultaneously, efforts at product differentiation may intensify in order to avoid price competition. Variety also appears as a result of specialisation. As efforts at differentiation increase, the acceptance of certain general standards will also grow. This change in the degree of standardisation has certain locational implications. First, there will be a decline in the need for locational flexibility since standardisation opens up technical possibilities for achieving scale economies through mass production. Standardisation also encourages long term commitments to some given process and some fixed set of facilities. Secondly, production cost will become a more relevant concern than product characteristics. The reduction of the uncertainties surrounding the operation appreciates the utility of cost projections and escalates the attention devoted to cost, even if intensified price competition has not occurred yet.

At this stage, a shift in the location of production facilities will usually occur. If the product has a high income elasticity of demand, or if it satisfactorily substitutes high cost labour, the demand in time will start to grow. Once the domestic market expands, firms will begin to consider setting up a foreign producing facility where there are more economical factors of production and labour cost is one factor that Vernon emphasises.

Vernon (1996) further claims that international investment decisions are not always rational processes. Instead, threat in general is a more reliable stimulus to these decisions. Threat takes various forms once a large-scale export business in manufactured products is developed. Indigenous firms in a host country, which are always the targets of these export activities, grow discontented at the opportunities they are missing. Local government will also be concerned with generating employment or promoting growth or balancing their trade accounts and hence start to contemplate ways and means to replace imports. Therefore, an international investment by the exporter becomes a discreet means of pre-empting the loss of a market.

Vernon (1966) also asserts that a threat to the status quo serves to explain what happens after the initial investment. Once a certain producer makes an international investment, other major producers from the same country perceive that their market share in global terms is imperilled. Concurrently, their ability to estimate the production cost structure of their competitors, who are operating distantly in an unfamiliar foreign area, is impaired. The uncertainty can be reduced by emulating the pathfinding investor and by investing in the same area. This may not be an optimising investment pattern and it may largely be costly, but it is least upsetting to the status quo. This argument resembles the construct of market power approach in the sense that both believe that possessing monopolistic power is an important element to success and hence firms strive to increase their market share.

Assessing the Contribution of International Product Cycle to MNE Models

The international product cycle model directed the later efforts at MNE models towards firm level case analysis of the dynamics of the choice of entry modality (Rugman, 1986). However, Vernon based this model too heavily on the situation in the USA in the 1950s and early 1960s. This limits its applicability in the contemporary business world, because the technological leadership enjoyed by the USA during the period in which the model is developed has given way to a more balanced technological competition between the USA, Europe and Japan. Furthermore, this model deals mainly with import-substituting investment, but the global integration of affiliates with MNCs has become increasingly more important since the 1970s (Cantwell, 1991). In response to the deficiency of this model, Kojima (1978) made an attempt to supplement it by appending offshore or export-platform types of investment, which is a trade creating investment, to the discussion. He compared Japanese FDI and that of the United States. He found that the former was primarily trade oriented and responded to the dictates of the principle of comparative advantage while the latter was mainly undertaken within an oligopolistic market structure. The pattern of FDI in the United State was anti-trade oriented and operated to the long-term disadvantage of both the donor and recipient countries. Moreover, he believes that timing and direction of FDI should be determined by market forces.

Criticism of Kojima's Theory

Dunning (1993) asserts that the point at which Kojima's theory ceases to be satisfactory as a general explanation of MNE activity is precisely that at which neo-classical theories fail to explain much of modern trade. They neither allow the possibility of market failure nor agree with the fact that firms are both producing and transacting economic agents. As a result, they are not able to explain the kind of trade flows that are based less on the distribution of factor endowments but more on the need to exploit the economies of scale, product differentiation and other manifestations of market failure. Neither can they explain trade in intermediate products based upon the advantages of common governance, which reflect the inability of the market mechanism to ensure the first-best international allocation of economic activity.

Owing to the fact that the investigation on FDI at a macroeconomic level is outside the scope of the present study, Kojima's work is not further discussed here.

2.1.1.5 Eclectic Paradigm

The theories examined in the above sections focus on different aspects of FDI. They have different assumptions and different level of analysis. Nevertheless, they are not mutually exclusive. There is a need to combine them in order to attain a full and rich explanation of patterns and growth of FDI (Buckley, 1990). Dunning's eclectic paradigm is an effort of such.

Dunning's (1993) eclectic paradigm integrates elements from different strands into a framework for examining international production in general and FDI in particular. The synthesis of ownership, location and internalisation advantages (OLI advantages) organises a range of variables likely to influence the 'who', 'where' and 'why' of FDI activities.

This paradigm aims at offering a general framework for determining the extent and pattern of both foreign-owned production undertaken by a country's own enterprises and that of domestic production owned by foreign enterprises. Simultaneously, it accepts that the tendency of the firms to own foreign income generating assets may be influenced by financial and/or exchange rate variables.

The intersection between a macro-economic theory of international trade and a micro-economic theory of the firm is where this paradigm stands. It begins with accepting the traditional trade theory in explaining the spatial distribution of some kinds of output. Then, he introduces the importance of the presence of both transactional and structural market failures to the explanation of such spatial distribution of output. Moreover, both the distribution of factor endowments and the modality of economic organisation are relevant to the explanation of the structure of trade and production. Besides, organisational systems, innovatory abilities and appraisal of and attitude to commercial risks of different firms differ.

According to Dunning (1977, 1981), three conditions need to be present for a firm to have a strong motive to undertake foreign direct investment and that three conditions are ownership, location and internalisation. This is known as the OLI framework.

Ownership Advantage

It is necessary for firms to possess some knowledge-based assets, such as special technological, management or marketing skills, trademarks, copyrights and patents, as some kind of competitive advantages over foreign rivals to overcome the inherent disadvantages of operating abroad in an unfamiliar environment. There are two reasons why these knowledge-based assets are more likely to give rise to direct foreign investment than physical assets. The first reason is that such assets can be transferred relatively more easily back and forth across space at low cost. The second reason is that knowledge often has a joint character in that it can be supplied to additional production facilities at very relatively low marginal cost.

Location Advantage

Tariffs, quotas, transport costs, and cheap factor prices, host countries' infrastructure as well as host countries' government policies are the most obvious sources of location advantages, but factors such as access to customers can also be important. These location advantages must be present in order to make it profitable to produce the product in the foreign country rather than simply produce it at home an export it to the foreign market.

Internalisation Advantage

In order to determine the choice between foreign direct investment and licensing, factors such as the form of corporate governance, the cost of internal transactions versus those in arm's length markets, and the specific characteristics of the knowledge and information to be transferred, along with resulting market failures involving concepts like bounded rationality, agent opportunism, and asset specificity need to be considered.

Transfers tend to be internal, instead of at an arm's length, when the products are new, complex, have no prior commercial application, and are produced by R&D-intensive firms. This is to avoid opportunistic behaviour and imitation by rival firms.

Models of internalisation tend to focus on characteristics of knowledge capital like non-excludability, asymmetric information, moral hazard, adverse selection, and incomplete contracting.

The Main Principle of the Paradigm

The main hypothesis of the eclectic paradigm is that the level and structure of a firm's foreign value-adding activities will depend on whether the four conditions listed below are being satisfied.

1. The firm possesses net ownership advantage over firms of other nationalities in serving particular markets. These ownership advantages mainly take the form of the possession of intangible assets that are at least for a period of time, exclusive or specific to the firm possessing them.

2. Assuming condition 1 is satisfied, it must be more beneficial to the enterprise possessing these advantages to use them itself rather than to sell or lease them to foreign firms. In other words, it must be more beneficial for it to internalise its advantages through an extension of its own activities rather than externalise them through licensing or other similar contract arrangements with independent firms.

3. Assuming condition 1 and 2 are satisfied, it must be profitable for the enterprise to utilise these advantages in conjunction with at least some factor inputs outside its home country. Otherwise, foreign markets would be served entirely by exports and domestic markets by domestic production.

The generalised predictions of the eclectic paradigm are straightforward. At any given moment of time, the more a country's enterprises possess ownership advantages (relative to those of another), the more they tend to internalise rather than externalise their use; and the more they find it in their interest to exploit them from a foreign location, the more the inclination for them to engage in overseas production.

Remarks

There are two points to note here. First, the concept of internalisation advantage of Dunning is different from that of the internalisation theory discussed in section 2.1.1.1. The internalisation theory mentioned in section 2.1.1.1 is a transaction cost based theory. It mainly captures the transactional market failure, which is exogenous to firms. The concept of internalisation of Dunning embraces both transactional and structural market imperfection. In other words, internalisation in Dunning's eclectic paradigm considers both the market imperfection that originates from outside the firm and the market imperfection that is created by firms using their asset power, as discussed by the market power approach. In the rest of this thesis, the word 'internalisation' is defined to mean Dunning's approach of internalisation unless otherwise stated. The second point to note is that eclectic paradigm's discussion on ownership specific advantages and internalisation advantage goes beyond the domain of economics. It involves some concepts of behavioural approach and strategic management (this is investigated in section 2.1.2).

2.1.1.6 Traditional Modes of Market Entry

The choice on the mode of entry is an important strategic decision a firm confronts when it chooses to serve a foreign market. The four common modes of foreign market entry are exporting, licensing, joint venture and wholly owned subsidiary. Due to the fact that all of these modes involve resource commitments, firms' initial choices of a particular mode are difficult to change without considerable loss of money and time (Root, 1987 in Agarwal and Ramaswami, 1992).

Because of its importance, a considerable amount of effort has been invested in the area of entry mode selection (two examples are: Agarwal and Ramaswami, 1992;

Horstmann and Markusen, 1987). Nevertheless, the choice of foreign market entry mode is outside the scope of the present study. Therefore, it is not discussed here in detail.

2.1.2 Theories Developed from Other Disciplines

The problem with FDI theories based on economics is that they ignore the behavioural aspect of foreign direct investment activities, such as culture, management and control that are also substantial to the success of FDI activities. In this section, theories incorporating the behavioural, managerial and strategic elements of FDI are examined.

2.1.2.1 Process Model

Process model, which focuses on the process of internationalisation of firms, is one of the theoretical lines based on behavioural approaches (Johanson and Vahlne, 1977; Wiedersheim-Paul *et al.*, 1978; Welch and Luostarinen, 1988; just to name a few). Basing on the behavioural theory of firms (Cyert and March, 1963; Aharoni, 1966 in Johanson and Vahlne, 1990) and Penrose's (1959) theory of the growth of firm, this model asserts that the internationalisation of the firm is a process in which the firm gradually increases its domain in global geographical terms. This process evolves in an interaction between the development of knowledge about foreign markets and operations on one hand and an increasing resource commitment to foreign markets on the other. Market knowledge and market commitment at a certain point in time are affected by historical activities and commitment decisions. Then, they are assumed to affect decisions regarding commitment of resources to foreign markets and the way current activities are performed. Afterwards, the process continues and therefore could be viewed as a causal cycle (Johanson and Vahlne, 1990).

An important feature of the process model is that it views a firm as a loosely coupled system in which different actors in the firm have different interests and concepts regarding the development of the firm (Cyert and March, 1963; Weick, 1969.

Pfeffer, 1981 in Johanson and Vahlne, 1990). This resembles the network approach that is discussed later.

The usefulness of the internationalisation process model lies in its ability to explain two patterns in internationalisation activities of firms (Johanson and Wiedersheim-Paul, 1975 in Johanson and Vahlne, 1990).

The first pattern is that the firm's engagement in the specific country market develops as an establishment chain. It usually starts off with irregular export activities. Then, export will be undertaken through independent agencies, which will be followed by through sales subsidiaries. Direct manufacturing in that market will eventually take place. This sequence of stages indicates an escalating commitment of resource to the market. During the first stage, virtually no market experience will be learnt. In the second stage, an information channel (that is the independent agencies) is established between the firm and the market and this provides the firms with regular but superficial information about the market conditions. As the firm, in the following stages, is directly engaged in activities in the market, more differentiated and wider market experience will be obtained.

The second pattern is that firms enter new markets with successively greater psychic distance, which is defined in terms of factors such as culture, language and political systems. These factors upset the flow of information between the market and the firm (Vahlne and Wiedersheim-Paul, 1973 in Johanson and Vahlne, 1990). Therefore, firms prefer to begin internationalisation by approaching markets with low perceived market uncertainty.

The two patterns manifest the process in the internationalisation of the firm. Similar findings have been presented in the discipline of international retailing. Myers and Alexander (1995 in Clarke and Rimmer, 1997), based on some empirical studies, suggest that management has become less 'reluctant', less 'cautious' and more 'ambitious' over time. Laulajainen (1987) and Treadgold (1991 in Clarke and Rimmer, 1997) also asserts that experience serves to overcome initial complacency.

The process model is originally built on the empirical work of Carlson (1966, 1975 in Johanson and Vahlne, 1990) on Swedish firms who were competing internationally. Later effort on a series of empirical work being conducted in different countries and situations has provided further support to the model (Johanson and Vahlne, 1990).

Knowledge

One essence of the internationalisation process model lies in the concept of knowledge accumulation. By borrowing the work by Edvardsson, Edvinsson and Nystrom (1993), knowledge can be conceptualised as something that is potentially useful for the product and company development. It can be in the form of technologies, or it can be financial or organisation knowledge, which is how companies ought to build their internal and external networks and competencies. According to Penrose (1959), there are two different kinds of knowledge. They are objective knowledge, which can be taught, and experiential knowledge, which can only be acquired through personal experience. Market knowledge, including the perceptions of market opportunities and threats, is assumed to be acquired mainly through experience from current business activities in the market. Experiential market knowledge generates business opportunities and subsequently, this acts as a driving force in the firm's internationalisation process. Nevertheless, it is further assumed that experiential knowledge is the principal way to reduce market uncertainty. Therefore, in a specific country, incrementally intensified resource commitment is expected as a firm gains experience from current activities in the market.

In section 2.1.1, knowledge was mentioned to be a salient source of competitive advantage in the context of FDI. In a similar vein, a number of scholars with behavioural background, besides agreeing on Penrose's view on knowledge, also recognise the importance of knowledge as a source of competitive advantage (for instances, Edvardsson, Edvinsson and Nystrom, 1993; Kogut and Zander, 1993; Kogut and Zander, 1995; Madhok, 1997).

Madhok (1997), who adopts the organisational capability (OC) perspective in his study, stresses on the difference between cost and value aspects in the management of know-how in order to achieve insightful analysis of the issues pertaining to the transfer of knowledge within and across firm boundaries and the exploitation and development of competitive advantage. He defines value in terms of the potential rent-generating ability of an asset or know-how. It is claimed that a balance between exploitation and development of knowledge is essential to the sustaining of rents earning (Hedlund and Rolander, 1990; March, 1991 in Madhok, 1997), because in the contemporary global market place, a complex set of capabilities, instead of a single one, is mandatory to competing successfully (Cantwell, 1991; Porter, 1990 in Madhok, 1997). Development of capabilities is more future-oriented and opportunity-seeking and has a greater emphasis on learning than exploitation of knowledge does (Hedlund and Rolander, 1990; March, 1991 in Madhok, 1997). It provides the potential for future value that can then be exploited whereas exploitation realises this value and engenders the resources for future development. Placing emphasis solely on exploitation can result in eventual depletion of an existing advantage. Similarly, development without exploitation can lead to wasteful expenditure of resources without realising the benefits from it. Therefore, development of capabilities and exploitation of knowledge are complementary to each other.

The treatment of 'knowledge' by the OC perspective (Madhok, 1997) is analogous to that of 'structural imperfection' by Dunning in his OLI paradigm (1988 in Madhok, 1997), but the OC perspective also goes further to claim that

> "the true source of competitive advantage and sustainable rents arises not from the more embodied and visible elements of the know-how but from the supporting structure, or complementary organisation capabilities around it, that would enable exploitation of this advantage" (Teece, 1986; Dunning, 1988 in Madhok, 1997:45).

In fact, scholars such as Bartlett, Kogut, Porter, Tallman and even Dunning (in Porter, Dunning, Teece, Kogut and Barlett, 1998) have also begun to direct increasing attention to the importance of the development of capabilities to sustainable competitive advantage in the recent years.

Another important issue related to knowledge is its transferability. Transaction cost theory assumes that knowledge is of a public good nature. Hence, in order to avoid opportunistic behaviour, firms undertake FDI so that knowledge is transferred internally. In contrast with this view, the OC perspective claims that knowledge has both a public good nature as well as a tacit characteristic and it concentrates on the discussion of the latter. According to this perspective, a firm's knowledge is embedded in its routines and is largely firm and context-specific. It could

> "suffer erosion of rent-generating potential, and consequently value, due to a weak transferability and imperfect replicability in a new context, thus weakening its competitive advantage" (Madhok, 1997:47).

Parallel to this concept is the construct of 'slippery space and sticky place' by Porter, Dunning, Teece, Kogut and Barlett (1998) that stresses on the immobility characteristic of knowledge. The only difference between the two concepts is that the OC perspective relates immobility characteristic of knowledge to the infrastructure and culture of a firm, whereas Porter *et al.* associate the immobility with the macro infrastructure and condition of the country in which the firm is located.

Pertinent to the firm's specific nature and transfer of knowledge is knowledge communication. Buckley and Casson (1976 in Kogut and Zander, 1993) point out that the personnel responsible for encoding and decoding information must be of similar backgrounds or operate in a similar environment, otherwise, misunderstanding will occur because the implicit assumptions of the decoder will be different from those of the decoder. If firms differ in their codes by which information is transferred, it follows reasonably that they should also differ in their capabilities to understand and apply knowledge (Kogut and Zander, 1993). In other words, knowledge is firm-specific and differential competitive advantages in terms of knowledge result even if all firms have equal access to the same piece of information. In fact, this view has been put forward by Vernon in as early as 1966, which has been discussed in section 2.1.1.4. On the other hand, this problem of encoding and decoding also sheds some light on the explanation of firm's expansion through FDI in a foreign country, in which better communication of knowledge is enabled (Kogut and Zander, 1993).

Relationships to Other Actors on the Foreign Market

Besides knowledge exploitation and development, relationships between the MNE and other actors in that foreign country is the other important attribute lying at the heart of the internationalisation process model (Johanson and Vahlne, 1977, 1990). The discussion on this attribute involves the concepts of the network approach, which is coming up in the following section.

2.1.2.2 Industrial Network Approach

The industrial network approach towards the study of FDI is a very recent tradition (Jarillo, 1988, Forsgren, 1989). The work of the Industrial Marketing and Purchasing (IMP) group, which successfully demonstrated that stable long-term relationships exist in the dyadic relationship between buyers and sellers of manufactured products (Hakansson, 1982), is regarded as a starting point for this tradition. A business network is defined as

> "a set of actors independent from each other from an institutional point of view but performing activities and/or controlling resources which are dependent in some way' and 'there is at least some agreement among the actors regarding the existence of these dependencies" (Hakansson, 1992:135).

One argument of the industrial network approach is that the reduction of uncertainty, fast access to information, reliability, and responsiveness are among the paramount concerns that motivate the participants in exchange networks. Knowledge and experience of using resources emerge when resources are combined. This in turn creates possibilities for new and improved combinations that serve as seeds for development and change; and change induces further change. This point is where the internationalisation process model intersects with the industrial network approach.

Exchange Relationships

Exchange relationships are basic elements in business networks. Although the business aspect is central in the business network, most exchange has a communication and a social aspect. Blau (1968) argues that economic exchange transactions are minor at the beginning and little trust exists between the parties engaged in the exchange. Trust between the parties increases slowly as trustworthiness of each party is incrementally proved through further exchange transactions. Easton and Araujo (1992) share a similar view. They claim that non-economic exchanges such as social exchanges are also present in industrial network. Hallen (1992) proposes further that contact networks, which are the organisation-centred and person-centred networks, are an integral part of industrial networks. He terms them infrastructural networks because they provide underlying preconditions and support for the industrial and business activities in international business.

Infrastructural contact networks are not designed for specific business deals. They lay the foundation for business dealings. They provide contacts to be used when required and they are important in handling links to parties with whom the company has no direct or indirect business relationships. In other words, the potential of engaging in business deals with other companies is enhanced by such networks. Moreover, they serve as a means of information and facilitate the handling of information flows to and from the company regarding issues that are extraneous. This implies that infrastructural network is capable of influencing the framework within which business is conducted. The capability of the infrastructural network to fulfil these functions depends on the extent of actual connections and their character in terms of their future connections as a second or third tier in the network, as well as the relative position or strength of influence of different actors in the network. Therefore, such network should be diverse, and should include many loosely joined contacts (Hallen, 1992).

Moreover, Easton and Araujo (1992) suggest that power dependence, proximity and mutual orientation are also important elements in such networks. This view is supported by Thorelli (1986:47) who states that "networking places a new emphasis on personnel. Power, expertise, perceived trustworthiness and social bonds are often person-specific rather than firm-specific."

Ties are formed between the persons engaged in the business relationships. Industries and countries may differ with respect to the relative importance of firm and person relationships, but it is believed that the personal influence on relationships is the strongest in the early establishment of relationships (Johanson and Vahlne, 1977, 1990).

Network Dynamics and Network Positioning

Hakansson (1992) claims that by basing on their historical experience and learning, actors specialise in performing certain activities in order to acquire more control in the network. In performing activities, resources are combined and in this process, mutual adjustment is made and knowledge about the resources and activities are gained. Due to the scarcity of resources, resources should be invested in economical ways. In other words, they should be invested in certain key areas. The actors will increase their efforts in utilising these resources by continuing the process if the result is rewarding. Consequently, a network structure where a decreasing number of actors control increasing amount of resources and activities will emerge. Other actors in the network will interpret the expected change and react according to their interpretation. Those who expect themselves to lose or who are already losing will try to break the power of the companies that are controlling the resources by separating the existing activities from those resources that are currently in use. Furthermore, they will search for alternatives and try to build up new networks. As a result, control exercised by the original leading firms will become less valuable to them. This process continues and a spiral results. Sometimes, the stability of the network could be intentionally disturbed and disrupted by actors in order to gain more control and power in the network. This intention could be driven by greed and scarcity of resources.

In a business network, each actor occupies a certain position (Mattsson, 1989). Such positions are established, maintained and developed over time through investment of resources. They also serve as assets on which future development of exchange relationships and strategic actions can be based (Johanson and Mattsson, 1985, 1990, and Mattsson, 1984). The actors in the networks have different power over activities The differential power is based on their network positions (Markovsky *et al.*, 1988, Thorelli, 1986) and the control over critical resources and activities via the relationships with other actors (Pfeffer and Salancik, 1978).

Foreign direct investment, according to the network approach, is investment in order to establish, defend and develop positions in foreign networks. If a firm has already established a position, FDI represents an attempt to defend or improve the position. If a firm is new to the network, FDI depicts the establishment of a new position, which is a difficult task in the short run (Forsgren and Johanson, 1992b). In this case, a gradual process of learning to mange exchange activities and subsequently to build up relationships (Seyed-Mohamed and Bolte, 1992) will be experienced. Johanson and Mattsson (1992) argue that there are three bases for the establishment of a position in foreign countries. First, the firm's original domestic network may be connected to the existing or potential exchange relationships in the new network. Secondly, a firm's own resources can be made interdependent with resources controlled by actors in the other network. Lastly, the firm's network theory can be communicated to other actors in the network in order to influence their actions.

Networking in Retailing

The discussion on infrastructural network is pertinent to the study of FDI of foreign retailers in China, because relationships, especially personal relationships, are important in Chinese business culture. Moreover, critical information such as the market structure, consumers' income and taste and rules on implementation of laws and regulations in China is difficult to obtain. Therefore, a well-established infrastructural network will enable a foreign retailer to access important information easily. Further discussion on Chinese business culture and practice is made in the appropriate places in the thesis.

On the other hand, networking is also relevant to the discussion on supply chain management. Power struggle between suppliers and retailers is an issue that has drawn the attention of many academics. As supply chain management is investigated in further detail in Chapter 7, it is not further discussed here.

2.1.2.3 Strategic Orientation: Globalisation vs. Multinational

In an attempt to study the extent of globalisation among corporations, Barlett and Ghoshal (1993) identified four forms of organisations used to manage international businesses. The typologies they used are multinational, global, international and transnational corporations.

Corporations are constantly searching to improve the management of their businesses. Over time, a particular type of organisation structure that facilitates its growth and international expansion will evolve. According to Barlett and Ghoshal (1993), different types of organisation structure emerge as a function of the need for firms to align their capabilities with the strategic demands of their business and the firm's administrative heritage.

According to the first factor, corporations that manage a portfolio of multiple national entities perform well when the critical strategic requirement is a high degree of responsiveness to differences in national environments around the world. When global efficiency is vital, it would be suitable for the firm to adopt a more centralised strategic and operational decision making and undertake a unitarian treatment of the world market. Finally, when transfer of knowledge is most important, a structure that leveraged learning by adapting the parent company's expertise to foreign market is favoured.

Under the first circumstance, multinational firms will establish a strong local presence through sensitivity and responsiveness to national differences. In the second situation, global companies will seek to achieve cost advantages through centralised global-scaled operations. In the last scenario, international companies will exploit parent firms' knowledge and capabilities through worldwide diffusion and adaptation.

On the other hand, company's administrative heritage is defined as the existing organisational norms, values, and behaviour of managers in its national companies and its historical context. A multinational company represents a decentralised organisation with distributed resources and delegated responsibilities. On the contrary, the global corporation manifests a centralisation orientation. Intensive communication and a complex system of personal interdependencies and commitment is the usual characteristic of such organisations. An international firm is willing to delegate responsibility while retaining overall control through sophisticated management systems and specialist corporate staffs.

As Barlett and Ghoshal (1989) point out, no particular organisation type is best suited for specific industries or countries. The choice on organisation form of foreign operations depends on their configuration of asset and capabilities, role of overseas operations and development and diffusion of knowledge.

The present study does not aim at investigating the relationship between the organisation form and the underlying conditions in which the particular form is employed. Instead, this study is more interested in the adaptation process of foreign retailers operating in China. When retailing is concerned, responsiveness to local consumer taste and style and supply chain structure is crucial. On the other hand, local staff in China are not experienced enough to be delegated with full responsibility. Therefore, the investigation on the adaptation process, both in terms of retail marketing strategies and supply chain management strategies, undertaken by the foreign retailers in China will hopefully offer some insights to the field of strategic international management.

2.1.2.4 Corporate Culture and Management Capabilities

As pointed out earlier, management capability is associated with the process of knowledge development, which is a source of competitive advantage for multinational enterprises in their FDI activities. At the same time, management capability is also related to corporate culture of a firm.

"Knowledge is essentially related to human action" (Nonaka and Takeuchi, 1995 in Lyles and Salk, 1996:879). It is created by individuals, while organisations only provide a context for individuals to create and augment knowledge (Nonaka and Takeuchi, 1995 in Lyles and Salk, 1996).

Top management takes an important role in knowledge acquisition. A number of scholars have envisaged the significance of sharing of experiences and prior learning among organisational members (Prahalad and Bettis, 1986; Lyles and Schwenk, 1992; Von Krogh, Roos and Slocum, 1994 in Lyles and Salk, 1996). Moreover, it is mainly the top management who defines knowledge structures. On the other hand, corporate culture, such as self-identity and a core set of beliefs, provides a legitimising function for assessing new knowledge acquisition in the context of the existing knowledge structure.

Cohen and Levinthal (1990 in Lyles and Salk, 1996) point out that some organisations possess greater capacity to assimilate, circulate and exploit information than others. High capacities for knowledge acquisition is largely witnessed in firms with flexible organisational structures and approaches to management. A plausible explanation to this observation is that organisational flexibility encourages greater receptivity of organisation members to new stimuli from the outside. A flexible organisational structure can be conceptualised as one in which collaboration and exchanges of information within the organisation is promoted; and greater latitude in altering activity patterns to adapt to perceived changing needs and conditions is vested to its members (Lyles and Salk, 1996).

According to the above discussion, it could be concluded that corporate culture is also an important element in the management of international business.

2.2 Fundamental Differences Between the Manufacturing Sector and the Retailing Sector

The traditional foreign direct investment theories that stem from the discipline of economics view foreign direct investment as an mechanism to arrange different activities in the value chain in different parts of the world based on the net benefits of joint ownership of domestic and foreign activities. These theories appear to be of limited applicability to the retailing sector because of the fundamental differences between the retailing sector and the manufacturing sector in the following aspects:

- The balance between centralised and decentralised decision making
- The relative importance of organisational and establishment scale economies
- The relative size of establishment to the size of the firm
- The relative exit costs if decisions are reversed
- The speed with which an income stream can be generated after an investment decision is made
- Different cash flow characteristics
- The relative value of stock and hence importance of sourcing
- The degree of spatial dispersion in the multi-establishment enterprise. According to Moore and Birkinshaw (1998), when a multinational retailer goes across national boundaries, it typically replicates almost the entire value chain in each country of operation. Unlike manufacturing firms that can rely on patented technologies or unique products, a retailer derives competitive advantages from its ability to make use of its proprietary knowledge on a global scale. In other words, competitive advantage is gained through the transfer of intangible assets from country to country. These intangible assets include the retailer's name, image, reputation, operating formats and procedures, and management know-how. The reader should note that under this situation, the ultimate source of these intangible assets is not the headquarter in its country of origin, because the world is not a homogeneous market. For a retailing firm, new knowledge comes primarily from the interactions with different markets around the world. Market interactions represent a two-way flow of knowledge, in which the retailer uses its

existing expertise to serve a market, and simultaneously the expertise of the retailer is enhanced and sharpened through usage and new knowledge accumulation. Markets evolve continuously. A retailer can only sustain its competitive advantage through continuous knowledge accumulation and exploitation.

In fact, attempts to relate Dunning's (1981) eclectic paradigm of internationalisation have been made by Pellegrini (1991) and Dawson (1994b). Nevertheless, their investigation leads them both to conclude that there are significant differences between retailing and manufacturing and hence while some concepts may be borrowed from the internationalisation process of manufacturing firms, the direct applicability of those frameworks to the internationalisation process of retailing firms is limited. Alexander and Lockwood (1996), Burt and Carralero-Encinas (2000), and Alexander and Myers (2000) share similar opinion.

Based on the above arguments, the present research looks into the behaviour of foreign direct investment undertakings of retailers in order to establish a framework with which the process of foreign direct investment in the retailing sector can be better understood. Figure 2.1 on the next page is an outline that includes the factors which appear to be pertinent to the process of foreign direct investment in food retailing. This outline serves as a blueprint on which the present research is built.

Figure 2.1 Outline of Factors that appear to be Pertinent to Foreign Direct Investment of Food Retailers

Supply Side

Sources of Retail Expertise that Contribute to Successful FDI

- Supply chain coordination and management
- Uniqueness of products offered (the retail store being the product)
    - Store Concept and format
    - Communication with customers
- Organisational Learning Orientation
    - Organisational learning
    - Development of human resources
    - History of Internationalisation
    - Relationships and structure between branches and head offices (export of corporate culture)
    - Market Orientation

Demand Side

Environmental Factors in Host Country that Affect FDI

- Legal and regulatory infrastructure
- Site acquisition
- Distribution structure
- Retailing structure and competition landscape
- Consumption pattern and consumer behaviour
- Business and social culture
- Availability of competent human resources

Export of retailing expertise

Adaptation required on the supply side

Foreign Direct Investment

Chapter 3
Background: An Economy in Transition

China is a market in transition from a command economy towards a more capitalistic economy. The country's open door policy was implemented in 1978. Many remarkable economic and social changes have been made over the last two decades. Nevertheless, some of the legacy of a command economy still presents difficulties to foreign businesses in China. In other words, an understanding of the characteristics of a transitional economy is important to firms that intend to enter China. Therefore, this chapter provides an overview of the macro characteristics of an economy in transition.

3.1 The Emergence of Transitional Economies

The breaching of the Berlin Wall in November 1989 marked the beginning of the unique and historic process of transformation from a command to a competitive market-based system in the countries of Central and Eastern Europe (CEE)--for example, Bulgaria, Czech Republic, Hungary, Poland and Romania. The transition to a market economy in these countries aroused public interest. Western governments, firms and international organisations are enthusiastic about involving themselves in this process of transformation by understanding, assisting, trading or investing in these countries. While the early price liberalisation and stablisation reforms in many of the countries of CEE appear to have been successful, this first stage of the transition has been accompanied by serious decreases in output, significant increase in unemployment, persistent medium level inflation and the re-emergence of fiscal deficits. Therefore, it is now obvious that the transition will be much more difficult and take far longer than anticipated.

In another part of the world, the People's Republic of China, economic reform has been underway for more than two decades. The aim of the economic reform is to transform the command economy into a new hybrid system-- a socialist market economy with Chinese characteristics. The main difference between the process of transformation in China and that in CEE is that the former does not involve any dramatic political reorientation as the latter does. China, having started the process of transformation earlier than the rest, has benefited from over a decade of rapid GDP growth, averaging 9.4 percent between 1978 and 1995 and remaining over 7 percent between 1996 and 2001[1].

The transition to the market is a long-lasting process. It brings about enormous challenges to all the countries undertaking the transformation. This present transition process has no historical equivalent or precedent. It is, at the same time, burdened with the legacies of the past. In the past, there was a debate as to the relevancy of the mainstream economics to the analysis of centrally planned economies. Furthermore, there has also been the debate over the necessity of creating theories pertinent to transition economies. When one believes that the command economies were a non-system now transforming into a fully-fledged market economy, there will be no need for a theory of the transition. However, the transition is now witnessed as a continuing process, resulting in a specific economic regime and hence it deserves a theoretical approach in order to avoid serious policy errors being committed in managing the transition (Lavigne, 1995). Moreover, China is a case of transition from a centrally planned economy but it is not towards a fully-fledged market economy. Instead, it is aiming at a transition towards a socialist market economy. China is seen as a case for a semi-reformed planned economy. For example, collective farms still remain but the household-responsibility system emerging within them offers incentives similar to those of private farming; responsibility capitalism is emerging in the field of service sector and small industry but the industry is still dominated by large state-owned enterprises that show most of the standard features of a command economy (Lardy, 1991 in Lavigne, 1995; Knell and Yang, 1992). The boom in the Chinese economy reflects the factors of genuine liberalisation and decentralisation in agriculture; the emergence of a new private sector; the opening up of the economy through quasi-convertibility of the currency and the position of the country in the early stage of the take-off. Following this line, China is an economy that embraces both pure capitalism and standard socialism (Lavigne, 1995). This is what the Chinese government calls a 'socialist market economy with Chinese

[1] See Appendix 1.1

characteristics'. In this case, the argument for the development of a theory pertinent to such transition is further consolidated. In the following section, the economics of transition will be discussed briefly.

3.2 The Legacy of the Command Economy

In a command economy, equity is the most important concern. Such an economy relies on material balances planning using input-output matrices to match available resources and the desired supply of final goods. Demand is derived from the outcome of previous iterations of the planning process and is a marginal consideration in arriving at output targets. Production capacity should be used for those goods considered essential or basic to health and well being of the population. The role of distribution system is to ensure that goods are allocated according to need and are available to all who need them. The only two key considerations for management of enterprises are to secure sufficient inputs and to meet quantitative plan targets. Marketing departments are primarily concerned with distribution of product and marketing simply means order processing.

Before the transition to a market economy, the central planning mechanism was an inflexible system. The plan directed those who were responsible for implementation, but at the same time, it did not give them a free hand, making it one of the sources of economic rigidity and lack of flexible adaptation. As a result, planners favoured very large integrated units in order to reduce the number of agents they had to deal with. Governments followed the practice of bailing out ailing enterprises through the banking system by offering credit, allowing tax rollovers or debt repayment deferrals, or even total forgiveness of debt. Consequently, enterprise managers always expected government planners to come to their rescue if they ran into financial difficulties. This led to a corrupting influence on economic efficiency by reducing a firm's sensitivity to the price of money, whether measured in terms of interest rates or exchange rates (UNIDO, 1994). The whole system of financial and fiscal regulation of state enterprises was infiltrated by discretionary considerations. The skillful negotiator with sufficient political connections could always obtain a bail-out. Therefore, it is important to destroy the discretionary link between the state and its enterprises in reform programmes in order to bring their budgets under control.

In terms of industrial structure, the most significant difference between a market economy and a command economy is the size of enterprises and the degree of industrial concentration within each industry. In a command economy, there was a relative absence of small and medium-sized enterprises. Privately owned enterprises were not encouraged or supported. The service sector was underdeveloped. Distribution and retailing were two particularly neglected sectors.

Product ranges were typically limited and life cycles were much longer than in a market economy. There was very limited investment in product development and innovation. Products were engineered to cope with capricious supplies of capital and material inputs. There was hardly any incentive to design products to meet consumers needs. Systematic market research was almost unknown and was virtually precluded by the organisation of industry. As a result, much management today in the transitional economies suffers from the lack of a thorough understanding of market trends and changes, pricing, and organising a sales force and modern distribution channels.

The concept of profit centres and core business was not central to economic life. Resources were invested to fill a production plan instead of on the basis of potential return. This resulted in the existence of unrelated product lines, the growth of non-core activities and a loss of business focus in a lot of enterprises. Financial and accounting systems were designed primarily as record keeping tools instead of as fully developed management accounting systems providing the information required for rapid decision making (such as the decision on which products are profitable and which are not) or as a basis for negotiating credit with a commercial bank.

In a typical state-owned enterprise, top management was appointed by the state bureaucracy. Upon the appointment, little attention was paid to the appropriateness of the professional skills of the manager concerned. Party membership was an important factor in career success. Effective enterprise-oriented management information system and training options in such fields as finance, marketing, sales, distribution and quality control hardly existed. As a result, very few top managers were able to break away from the quantitative bias of the ubiquitous plan targets and develop a market-oriented managerial culture.

On the other hand, product and process technology was often obsolete in those command economies. Enterprises mainly relied on outdated equipment operating in an unsuitable production environment with inefficient production methods. The non-existence of commercial incentives to maintain equipment properly or to manage inventory efficiently also meant that quality control procedures were inconsistent and could not be relied on to deliver products meeting international quality standards.

All of these problems of the previous command economies are a manifestation of the claimed shortcomings of a centrally planned system by the advocates of market force led or market-based economy, who emphasise that equity emerges from an efficient system. They believe that a centrally planned system, no matter how well intentioned, will end up misallocating a country's resources and encouraging inefficiencies in production and distribution, because without a competitive marketplace, no incentive is provided to produce or distribute efficiently. They see inefficiency as a greater deterrent to development than inequity. They argue that consumers are better judges of their own needs than government and consumers can determine what will be produced by what they buy and do not buy. They further assert that a change from a centrally planned to a market-based economic system unleashes forces that lead to a significant, sustained increase in the rate of economic growth because of the efficiencies that are introduced (Vernon-Wortzel and Wortzel, 1987).

Transition towards market economies is well underway now, both in CEE and in Asia. However, it is recognised that the restructuring process requires an adequate environment, which was absent in the command economies. The non-existence of a well developed legal and regulatory system also represents another challenge to the process. In the following section, the framework for transition will be presented.

3.3 The Process of Transition

The transition process usually involves implementation of the following reforms (Lavigne, 1995). First, there is the macroeconomic stabilisation. Secondly, transition economies liberalise prices, legalise non-state enterprises, and end legal discrimination based on type of ownership. Thirdly comes the external liberalisation that removes trade and investment barriers and rationalises the exchange rate regime. Fourthly, there is a transformation of the system of property rights that leads to the privatisation of state-owned enterprises and new institutional arrangements supporting private ownership.

The objectives of the macroeconomic stabilisation are to prevent hyperinflation, to eliminate price distortion caused by subsidies and lack of competition, to reduce budget deficits and credit growth, and to establish monetary and fiscal balance in a market based economy. With the removal of subsidies, the imposition of a credit crunch and increased competition from imports, most enterprises can no longer employ cost-plus pricing behaviour, therefore removing a major source of inflationary pressure and macroeconomic instability. A punitive tax-based incomes policy to control wage expansion is another tactic to secure the initial objective of stable prices during the interregnum between the dissolution of central planning controls and the introduction of a hard budget constraint.

When the threat of domestic inflation is removed, the establishment of a stable exchange rate and unrestricted current account convertibility is feasible. Fixing the exchange rate assists in bringing inflation down rapidly. State enterprises unfamiliar with competitive pricing strategies are provided with foreign prices as a nominal reference point for domestic prices. These prices offer accessible and clear criteria for monitoring improvements in efficiency and cost performance, which are essential for surviving with a hard budget constraint.

In the process of setting the correct exchange rate, undervaluation of the currency is usually undertaken initially so that incentives for exports are provided and scope is left for upward revision of wages and prices that are bound to be required in the first few months of the stabilisation programme. Overvaluation will follow at a later stage because not all domestic price adjustments are tied to world prices and not all budget constraints will be hardened immediately. Therefore, in order to prevent domestic production being overwhelmed by cheaper imports and export markets being lost, policy makers have to prepare for excessive real appreciation. At the same time, the real exchange rate is affected by the consistency between fiscal policy, inflation and exchange rate policy.

On the other hand, the process of progressively hardening the budgets of the state sector is more than simply a matter of macroeconomic policy. It also involves institutional reform and legal and regulatory infrastructure. For examples, bank loan officers need to possess the knowledge of how to deal with defaulters; and tax collectors have to be capable of reading account and prosecuting for non-payment. Moreover, if the government is serious about macroeconomic stabilisation, no bail outs will be forthcoming for distressed firms. This leads to wider political questions about the stability of governments, the sharing of the social costs of economic restructuring and the capacity and capability of institutions to alleviated hardship.

3.4 The Case of the People's Republic of China: a "Socialist Market Economy"

1978 saw the beginning of the implementation of the economic reform in China. More than two decades have elapsed, during which, China has experienced a remarkable economic growth. As mentioned at the beginning, it has had a GDP growth averaging more than nine percent a year during 1978 to 1994, and its GDP has remained over 7 percent between 1995 and 2001.

The main elements of the reform have been: land reforms geared to boosting rural incomes, transfer of profits and labour from farming to industry; high saving rates to finance industrial investment, low taxes; intensifying competition in the home market and openness to foreign influence. The last element is composed of a combination of foreign prices, goods, investment and technology, with the objective being to bring world standards to the local economy.

The economic reform in China is a gradual process, with the coexistence of a market and a command economy, as mentioned before. Even though it has made impressive progress, it also suffers from corruption, political interference and the temptation to override the market signal as a result of the coexistence of command and private sectors. The theme of the Chinese economists' argument against quick comprehensive reform is that it has the same defect as central planning. They believe that a quick comprehensive reform forces governments to confront too many important decisions about which it is not very knowledgeable, such as how to sequence reforms and how to privatise. In fact, Woo, Parker and Sachs (1997) argue that 'gradualism' is more an unintended evolutionary process than a 'chosen strategy' and they claim that there are mainly two reasons for this unconscious outcome. First, there was a lack of a clear perception of the situation and a practical long-term plan in 1978 when the reform was intended to proceed. Secondly, there has been an absence of a common vision at the elite level. There was no consensus regarding the relative role of planning and markets in resource allocation. This also explains why China's gradual reform has been characterised by a gradual changing of its reform objectives. China has proceeded through a lengthy path of readjusting its reform objectives, from "a planned economy with some market adjustment", to "a combination of plan and market" and lately to "a socialist market economy". The changes in objectives indicate that there is a gradual increase in knowledge in China about the merits of different resource allocation mechanisms, that there are changes in the political balance between various interest groups and that there are changes in economic structure resulting from the process of reform and development itself.

The success of the gradual reform in China is also due to its other initial conditions. At the initial stage of the reform, China was a developing country with a large and mostly self-sufficient agricultural sector, a low degree of specialisation, and abundant surplus labour. Therefore, it could afford to delay privatisation of large state enterprises, allowing the non-state sector to outgrow the state sector and improving productivity in both sectors. Instead of privatising large state enterprises at the outset and forcing state-owned enterprises to become more efficient for survival, the increase in productivity was first triggered in rural areas and competition in domestic markets was increased afterwards. Low productivity agricultural based labour was able to move into the higher productivity non-state enterprise activities that flourished with the ownership reforms. In addition, liberalisation and focus on export production accelerated China's move into higher productivity manufacturing, provided higher access to international capital and modern technology, and increased overall efficiency and innovation by forcing Chinese firms to face world competition and world prices (Woo, Parker and Sachs, 1997). The key challenges China is confronting are the restructuring of the state enterprise sector, the clarification of ownership rights in the non-state sector, the improvement of market-supporting institutions such as the legal framework and the tax system and the reform of government, such as streamlining the administration, reforming the fiscal sector, revamping the financial system and redesigning monetary policy.

Situation Relevant to Retailing Before the Economic Reform in the PRC

China is a developing country with the largest population, 1.2 billion, in the world. As noted, in terms of economic development, it is the only former centrally-planned economy which has had a relatively high and sustainable growth for the past two decades. Retailing in China is also gradually moving towards modernisation and has remarkable prospects. Any study of retailing development in China during the last fifteen years will reveal a dramatic change.

Prior to the economic reform, China, like other communist countries, was a shortage economy. Production and distribution of commodities were planned and monitored by the central planning bureau, the Ministry of Commerce and Ministry of Materials. Most of the marketing and distribution channels at that time were state-owned. Wholesaling and retailing existed merely for administrative purposes. In contrast with a market-led economy emphasising efficiency, a centrally planned, command economy treats equity as its primary concern. Production preference was given to those goods considered essential or basic to the health and well-being of the population. Luxury goods were produced using extra production capacity after the basic needs of the populace have been fully met. The aim of the distribution system was to ensure that goods were allocated according to need and were available to all who needed them. In such a system, competition did not exist. Without a competitive marketplace, there was no incentive to produce or distribute efficiently. As time passed, misallocation of resources and inefficiency in production and distribution was the result (Vernon-Wortzel and Wortzel, 1987).

Moreover, under such a command economy, the concept of 'production' was limited only to the manufacturing sector. The distribution sector had been considered unproductive. As a result, much lower level of investments was made in the distribution and retailing sectors than in the manufacturing sector. Furthermore, in the traditional Chinese culture, people working in the distribution and retailing sectors were considered to be of lower status than those engaged in the sectors of education, government, farming and manufacturing. Consequently, retailing in China before the economic reform was seriously underdeveloped. Inefficiency characterised the whole retailing sector. The retail outlets did not match the needs of the accelerating population growth adequately in geographically concentrated urban areas. Long queues could be easily observed outside retail stores. Choice in selecting products was limited as there was only a little variety of product items available. The concept of customer service hardly existed (Mun, 1988).

Since the economic reform, the retail market in China has been gradually recognising the need of its population. Distribution is no longer a state monopoly. The formation of individual, private and collective enterprises has been encouraged. More autonomy has been granted to state enterprises (Yip, 1995). As a result of this reform, profound changes in distribution structure, consumption behaviour and environment for foreign-invested enterprises in retailing were brought about.

3.5 Role of Foreign Direct Investment in the Transition

Massive amounts of restructuring and new technology will be required for successful transformation of the economies. The savings of the countries experiencing the transition will not be enough to finance this. Therefore, the promotion of foreign direct investment is given major attention by these countries. Besides bringing in the needed funds for purchasing new machinery and equipment and updated technology, FDI also brings in the knowledge of the mechanisms of a market economy and access to new markets. These are some of the most important factors required for a successful transition in countries in CEE and in Asia.

China, in the search for economic modernisation, has also suffered from two serious bottlenecks, namely the lack of savings for capital formation and foreign exchange constraints (Nyaw, 1996). As a result, China has sought an inflow of foreign capital to increase its capital formation and foreign exchange earnings by attracting export-oriented industries to the country. Moreover, foreign investment also facilitated technology transfer and management techniques transfer, which are desperately needed by China for a successful modernisation.

The contractual values of FDI inflow in China amount to about US$614 billion, while the realised values were approximately US$308 billion during the period of 1979-2001 (November), as shown in Table 3.1. During the period of 1979 to 1999, 3.58% of the total contractual foreign direct investment value was made in the sector of wholesaling and retailing, and catering, as shown in Table 3.2. In 1999, 2.39% of the total realised foreign direct investment value is accounted for by the same sector (Table 3.3). China is one of the major recipients of FDI in the world. The country is the world's second largest recipient, after the United States, between 1995 and 1997 (Table 3.4). It is the seventh largest in 2000, after the United States and five Western

European countries (Table 3.4). In 2000, China's FDI inflow accounted for 17% of the total FDI inflow into developing countries and economies (Table 3.4).

Table 3.1 Total Foreign Direct Investment in the PRC, 1979-1994 (Unit: US$ 100 million)

Year	Number of Projects	Contractual Values	Actually Utilised Values
1979-82	920	49.58	17.69
1983	638	19.17	9.16
1984	2166	28.75	14.19
1985	3073	63.33	19.56
1986	1498	33.30	22.14
1987	2233	37.09	23.14
1988	5945	52.97	31.94
1989	5779	56.00	33.93
1990	7273	65.96	34.87
1991	12978	119.77	43.66
1992	48764	581.24	110.08
1993	83437	1114.36	275.15
1994	47549	826.80	337.67
1995	37011	912.82	375.21
1996	24556	732.76	417.26
1997	21001	510.03	452.57
1998	19799	521.02	454.63
1999	16918	412.23	403.19
2000	22532	626.57	407.72
2001 (Jan.-Nov.)	22915	604.06	418.97
TOTAL	386985	7367.80	3903.00

Sources:

Figures for 1979-1999:
Hong Kong Trade Development Council. 2000. *Statistics of China's Utilisation of Foreign Direct Investment, 1979-1999.* 23 October. [Online] Available from: URL: http://www.tdctrade.com/report/stat/001004.htm [Accessed 17 February 2002].

Figures for 2000:
Hong Kong Trade Development Council. 2001. *An Account of Foreign Investment Used in China in Jan.-Dec., 2000.* 5 February. [Online] Available from: URL: http://www.tdctrade.com/report/stat/010201.htm [Accessed 17 February 2002].

Figures for 2001 (Jan.-Nov.):
Hong Kong Trade Development Council. 2002. *An Account of Foreign Investment Used in China in Jan.-Nov., 2001.* 21 January. [Online] Available from: URL: http://www.tdctrade.com/report/stat/020101.htm [Accessed 17 February 2002].

Table 3.2 Foreign Direct Investment in the Sectors of Wholesaling and Retailing, and Catering in the PRC, 1979-1999 (Unit: US$ 100 million)

Industries	Number of Projects	Proportion (%)	Contractual Value	Proportion (%)
Total	341538	100.00	3137.17	100.00
Farming, forestation, husbandry, fishing	9,534	2.79	108.27	1.76
Industry	249,352	73.01	3,655.47	59.50
Building	8,826	2.58	188.60	3.07
Transportation, traffic, post & telecommunications	3,721	1.09	149.69	2.44
Wholesales and retailing, catering	17558	5.14	219.60	3.58
Real estate, public services	33,877	9.92	1,499.77	24.44
Hygiene, sports social welfare	999	0.29	46.18	0.75
Education, culture, arts, broadcast, movie, and TV	1,317	0.39	20.40	0.33
Scientific research, technological services	2,410	0.71	18.74	0.31
Others	13,944	4.08	230.45	3.75

Source:
Hong Kong Trade Development Council. 2000. *Statistics of China's Utilisation of Foreign Direct Investment, 1979-1999.* 23 October. [Online] Available from: URL: http://www.tdctrade.com/report/stat/001004.htm [Accessed 17 February 2002].

Table 3.3 Foreign Direct Investment in the Sectors of Wholesaling and Retailing, and Catering in the PRC, 1999 (Unit: US$ 100 million)

Industries	Number of Projects	Proportion (%)	Contract-ual Value	Proportion (%)	Actual Input	Proportion (%)
Total	16918	100.00	412.23	100.00	403.19	100.00
Agriculture, forestry, husbandry, fishing	762	4.50	14.72	3.57	7.10	1.76
Excavation	130	0.77	3.22	0.78	5.57	1.38
Manufacturing	12,042	71.18	253.32	61.45	226.03	56.06
Electric power, gas and water production and supply	116	0.69	16.35	3.97	37.03	9.18
Building	247	1.46	10.96	2.66	9.17	2.27
Geology, water conservation management	10	0.06	0.54	0.13	0.05	0.01
Traffic and transport store and post and telecommunications	205	1.21	11.14	2.7	15.51	3.85
Wholesale, retail trade, catering	825	4.88	12.04	2.92	9.65	2.39
Finance, insurance	3	0.02	0.37	0.09	0.98	0.24
Real estate	669	3.95	41.78	10.13	55.88	13.86
Public services	1,474	8.71	30.17	7.32	25.51	6.33
Hygiene, sports and social welfare	28	0.17	0.67	0.16	1.48	0.37
Education, culture, arts, broadcast, movie and TV	29	0.17	0.73	0.18	0.61	0.15
Scientific research and comprehensive technical services	62	0.37	1.34	0.32	1.10	0.27
Others	316	1.87	14.89	3.61	7.53	1.87

Source:
Hong Kong Trade Development Council. 2000. *Statistics of China's Utilisation of Foreign Direct Investment, 1979-1999.* 23 October. [Online] Available from: URL: http://www.tdctrade.com/report/stat/001004.htm [Accessed 17 February 2002].

Table 3.4 FDI Inflows 1989-2000

Year	1989-1994 (Total)	1995	1996	1997	1998	1999	2000
World Total	200145	331068	384910	477918	692544	1075049	1270764
United States	42535	58772	84455	103398	174434	294976	281115
China	13951	35849	40180	44237	43751	40319	40772
FDI inflow in China/ World total (%)	6.98	10.83	10.44	9.26	6.32	3.75	3.21
Ranking of FDI inflow in China in the world	3rd	2nd	2nd	2nd	3rd	8th	7th
Developing countries and economies total	59578	113338	152493	187352	188371	222010	240167
FDI inflow in China/ Developing Countries and economies total (%)	23.42	31.63	26.35	23.61	23.23	18.16	16.98

Data from:
UNCTAD. 2001. *World Investment Report 2001.* [Online] Available from URL: http://www.unctad.org/wir/contents/wir01content.en.htm [Accessed 17 February 2002].

How rapidly foreign investment will continue to expand in China depends on the demand for and supply of foreign investment. The demand is affected by the rate of capital formation in China and the ability of China to absorb foreign capital. As noted earlier, foreign investment constitutes part of the capital formation in China. It creates future flows of goods from China through its earnings. The ability of China to absorb foreign capital depends on the availability of resources in China that are complementary to the imported capital goods in production. A new machine may require certain skilled workers to operate. Operation of a computer requires skilled maintenance personnel, programmers, and users. It takes time to acquire these complementary inputs. The import of foreign capital goods at a rate higher than that can be supported by the available complementary goods would not be economically efficient.

On the supply side, foreign investors have to take profitability of their investment into consideration. The usual problems that come along with foreign direct investment in a transition economy include a lack of both physical and service infrastructure, uncertain property rights, inadequate financial information on which to value a target enterprise, a lack of sufficiently trained personnel, economic and political outlook and stability of the country for investment, existing regulatory and legal framework, prospect for business growth, employment, inflation and other factors that will affect domestic purchasing power.

In the case of China, there are several particular issues with which foreign investors have to contend when considering investing in China. Firstly, the legal system has yet to be modified and made known to foreign investors to give them sufficient familiarity with and confidence in the system. Secondly, business practices in China have to be improved. One of the problematical practices is that of the Chinese government bureaucrats, who do not have the knowledge to run businesses efficiently and are difficult to work with. Lastly, the Chinese government itself has to make sure that it complies with its own regulations. It controls the power of approving contracts related to joint ventures, compensatory trade and cooperative management. It is not unusual for the government bureaucrat to violate a contract.

There is no denying that foreign direct investment facilitates the modernisation and transition processes in China. However, the future development of foreign direct investment will depend on the improvement of investment climate in the country.

Chapter 4
Methodology

"No matter what the state of the field, whether it is new or mature, all of its interesting research explores. Indeed, it seems that the more deeply we probe into this field of organisations, the more complex we find it to be, and the more we need to fall back on so-called exploratory, as opposed to 'rigorous,' research methodologies (p. 109)...while I believe we need empirical data to generate our categories—systematic data reinforced by a good deal of anecdote—I do not expect them to come from mechanical data reduction techniques. It is pattern recognition we are after, in the form of those creative leaps, and I believe that human, not electronic, brains are most capable of achieving those leaps (p. 114-115)."

Mintzberg (1983)

The present research intends to inquire into the nature of the foreign direct investment behaviour of food retailers. The study endeavours to understand "what is happening" in the process of retail foreign direct investment undertakings[1]. Therefore, this study takes a qualitative perspective and involves developing ideas through induction from data obtained from diverse sources[2].

According to Yin (1994), case studies are considered an appropriate approach when the research concerns how and why questions. Such an approach is particularly useful when the purpose of research is to examine the "more complex issues[, which are beneath the surface of a phenomena,] of what is meant by what is happening" (Edwards *et al.*,

[1] According to Van Maanen (1983), the question of "what is going on here", which seeks to "disclose and reveal" (p.256) the totality of a situation in a given place and time, is the elementary and fundamental concern in qualitative research.

[2] This concept is termed 'analytic induction'. This concept contrasts the hypothetico-deductive model, which aims to confirm or reject hypotheses of universal significance. Van Maanen (1983) claims that qualitative research work should commence with a close-up, firsthand investigation of ongoing social life. Specific elements of the studied phenomenon are then sought. Patterns may or may not emerge. Generalisations are to be developed from the ground up and are offered tentatively on the basis of their ability to comprehend the whole spectrum of data in hand. The reader should note that the generalisation that qualitative research concerns is analytic generalisation, which is generalisation to theory, not statistical generalisation, with which an inference is made about a population or universe (Yin, 1994).

1994:86). In other words, case studies provide an in-depth, intensive look at a research question or issue, which is a specific situation rather than a whole population or society (Rose, 1991:196). Therefore, the case study approach is chosen as the research approach for the present study.

4.1 Research Design

The fieldwork was conducted between April and September in 1999 in Beijing, Shanghai, Guangzhou and Shenzhen in China[3]. These cities have always been the four locations with the highest average urban per capita disposable income in China[4]. They are also among the cities that have the longest history of economic and political reform and hence are the most developed in economic terms. Due to these characteristics, these cities were chosen by foreign retailers and as a result were also chosen for the study.

There were no official lists of foreign food retailers in China available. A wide variety of business magazines, newspapers and journal and book publications were consulted before the fieldwork in order to compose a list of foreign retailers who had operations in the above four locations in China. Subsequently, a list comprising about twenty companies was generated. As a first step, the author contacted the headquarters of all those companies in writing, requesting to conduct case studies with their subsidiaries in China. Co-operation was obtained from several companies. The Chinese subsidiaries of those companies who did not grant permission to the author were contacted again by telephone when the author was in China. By these two methods and personal references, the author gained access to thirteen foreign food retailers in China. Case studies with these thirteen companies form the backbone of the present research[5].

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[3] The readers should note that China cannot be treated as a single homogenous market for the following reasons. First, the disparities of income between the coastal cities and the inner provinces and between the cities and towns suggest that the market potential varies widely across those locations. Secondly, the exposure of the southern population to foreign mass media, especially those from Hong Kong, leads to differential buying behaviour between the southern population and the northern population (Yip, 1995).

[4] The economic situation of these cities is discussed in more detail in Chapter 6.

[5] The present study uses multiple cases because "the evidence from multiple cases is often considered more compelling, and the overall study is therefore regarded as being more robust" (Herriott and

Although the present research adopts the analytic-induction approach, a "rough working frame"[6] (Miles, 1983:119) was established before the fieldwork was undertaken in order to minimise the risk of obtaining "an incoherent, bulky, irrelevant, meaningless set of observations...which no one can (or even wants to) makes sense of" (Miles, 1983:119). Such "working frame" was developed according to the present research objective and research questions and the existing literature and past studies on the subject area. Based on this "working frame", a case study memorandum that served as a loosely structured guide (Easterby-Smith, Thorpe and Lowe, 1991) and incorporated the topics of which the author would like to obtained information from her fieldwork, was produced[7]. The reader should note that the "working frame" was not meant to be a "self-blinding framework" (Miles, 1983:119). It instead served as a guiding blueprint for the research project and was repeatedly revised over the life of the research project as data were gathered and analysed. This led to the evolution of a proper framework that the present research attempts to establish[8].

4.1.1 Sources of Evidence

Employing multiple sources of evidence enables the researcher to corroborate and address a broader range of historical, attitudinal and behaviour issues. Any findings or conclusions reached in case studies using multiple sources of evidence, as a consequence, tend to be much more convincing and accurate (Yin, 1994). Therefore, the present research employs three sources of evidence: interviews, documentation and direct observations.

Firestone, 1983 in Yin, 1994: 45). The reader should note that the logic behind using multiple cases is a replication logic, which is analogous to that used in multiple experiments in science, instead of a sampling logic, which requires an operational enumeration of the entire universe and a statistical procedure for selecting the specific subset of respondents to be surveyed. For more details on replication logic and sampling logic, please see Yin (1994).

[6] This 'working frame' is presented at the end of Chapter 2, which outlines the factors that the author believes to be pertinent to foreign direct investment in retailing.

[7] See Appendix 4.1

[8] The method of analysis used for the present research is discussed in more detail in section 4.2.

Qualitative Interviews

Interviews are considered one important source of case study information (Yin, 1994) and it is the main source of information in the present study. Qualitative interviews allow the investigator to explore the mind of the interviewees, to see and experience the world as the interviewees do themselves (McCracken, 1988). The main purpose of conducting qualitative interviews in the present study is to understand how key informants construct the meaning and significance of the foreign direct investment situation they face, based on their complex personal framework of beliefs and values that they have developed over their lives and their experience in the industry[9]. Such purpose is best served by using in-depth, semi-structured interviews with open-ended questions (Easterby-Smith, Thorpe and Lowe, 1991). Furthermore, this format of interview provides directions for information collection and yet gives the researcher sufficient flexibility to explore further or discard certain lines of inquiry throughout the process of data collection and the entire research project. This is significantly important to qualitative research (Glaser and Strauss, 1965 in McCracken, 1988; Jones, 1985 in Easterby-Smith, Thorpe and Lowe, 1991; McCracken, 1988). Therefore, this format of interview was adopted for the present study. The topics of inquiry in the case study memorandum serves as the open-ended questions that were used in the interviews[10]. Elaboration by the interviewees on these questions was expected and encouraged during interviews.

The purpose of the present research involves understanding issues at the strategic level and therefore top management executives from the foreign side of the thirteen food retailers in China were interviewed[11]. The basic nature of these thirteen retailers and the position of informants in each of these companies are listed in Table 4.1. When

[9] According to Burgess (1982 in Easterby-Smith, Thorpe and Lowe, 1991), understanding how individuals construct meaning of their situation based on their complex personal framework of beliefs and values is the main concern for conducting qualitative interviews.

[10] The reader should note that the case study memorandum serves as a blueprint for the author to collect information from various sources. It is not a questionnaire that is given to the interviewees to fill in.

[11] All foreign food retailers were only allowed to operate as foreign-Sino joint ventures in China at the time of study.

negotiating access, the author promised confidentiality of the information obtained. Therefore the names of the companies and those of the informants cannot be disclosed. Confidentiality is also the reason that the author could only provide limited information, which is crucial to the arguments of the study, about the true nature of those companies in the thesis. Wherever possible, the interviews were conducted on a one-to-one basis, as indicated in Table 4.1. As the author speaks fluent English, Mandarin and Cantonese, the majority of interviews were carried out in one of these languages, depending on which language the interviewees felt most comfortable, as indicated in Table 4.1. The only two exceptions to this situation are Companies H and K, when the interviews were conducted with the presence of an interpreter, as indicated in Table 4.1. Although the author had endeavoured to gain as much access to the informants as possible, there were limitations imposed by the companies studied. The author could not obtain all the information she wanted as set out in the case study memorandum because some interviewees refused to discuss certain areas. The number of informants that the author was able to interview was also limited by the accessibility the companies granted the author. Some companies allowed the author to interview up to four of key executives while some others only gave the author access to one executive. The duration of each interview varied from one hour to four hours, which again was largely determined by the informants. Due to time constraints on both the retailers' side and the author's side, and cost constraints on the author's side, face to face follow-up interviews were only conducted with one company. Follow-up inquiries with other companies, as allowed by the retailers, were conducted by either fax or emails. With the consent of the interviewees, the majority of the interviews were tape-recorded to facilitate the analysis process.

Table 4.1 List of Companies and Informants Interviewed

Pseudonym Company Name	Geographical Location in China	Country of Origin	Position of Informants [(E) indicates the person is an expatriate; (L) indicates the person is hired from China locally]
A	Shenzhen	Asia (Hong Kong)	-Director, China development*** (E)
B	Shenzhen	USA	-Vice President* (E); -Senior Merchandising Director(1)* (E)
C	Guangzhou	Asia (Japan)	-Director and Senior Manager # (E); -Managing Director # (E); -Manager of Supermarket Division** (L)
D	Guangzhou	Europe (Holland)	-President, South China Region* (E)
E	Guangzhou	Asia (Hong Kong)	-Executive Director, Finance*** (E); -Vice President, Asia Region, of a company (with headquarter in Singapore) closely associated with Company E(2)*
F	Shanghai	Europe (Germany)	-Chief Operating Officer, Region Asia* (E); -Chief Executive Officer* (E); -Chief Food Purchasing Officer* (E); -Chief Non-Food Purchasing Officer** (E)
G	Shanghai	Asia (Taiwan)	-Operating Division Specialist** (E)
H(3)	Shanghai	Asia (Thailand)	-Assistant General Manager** (E); -Secretary to General Manager** (L); -Store Manager** (L)
I	Beijing	Europe (France)	-General Manager** (E)
J	Beijing	Asia (Hong Kong)	-Buying Manager* (E)
K(3)	Beijing	Europe (Holland)	-General Manager* (E); -Manager, Food Commercial Division* (L)
L	Beijing	Asia (Japan)	-General Manager of the distribution centre of Company L* (E); -Deputy General Manager, Beijing, of a company closely associated with Company L* (E)
M	Beijing	Asia (Japan)	-Vice General Manager ## (E)

Notes:

(1) The author was unable to interview this informant face to face due to time constraint and therefore a telephone interview was conducted with him.
(2) This informant did not locate in China and therefore no face to face interview was conducted with him. Inquiry with this informant is made by several email correspondences.
(3) All the informants were interviewed at the same time.

* Interviews were conducted in English
** Interviews were conducted in Mandarin
*** Interviews were conducted in Cantonese

During the interview, the interviewee spoke in Japanese and the author spoke in English. The interview was conducted with the facilitation of an interpreter.
During the interview, the interviewee spoke in Japanese and the author spoke in Cantonese. The interview was conducted with the facilitation of the Representative, Beijing Office, of Company M, who was a Japanese expatriate and spoke both Japanese and Cantonese.

In order to cross-check and compare the information obtained from the interviews with those thirteen retailers, and to gain further insights into the retail and distribution industry in China, in-depth, semi-structured interviews using open-ended questions with some Chinese government officials and the industry specialists were conducted. Again, names of the interviewees cannot be disclosed because the interviewees wished to remain anonymous. A list of their identities is presented in Table 4.2. The questions inquired in these interviews were also based on the case study memorandum.

Table 4.2 List of Interviewees in Independent/Governmental Organisations

Geographical Location in China	Organisation	Position of Interviewees
Guangzhou	US Agricultural Trade Officer	The Agricultural Specialist
Shanghai	US Agricultural Trade Officer	The Marketing Specialist
Shanghai	Roland Berger (Shanghai) Ltd, International Management Consultants	A Senior Consultant, and a Junior Consultant
Shanghai	Shanghai China Commercial Association	The Vice Director & Vice Chief Secretary
Shanghai	Shanghai Commercial Policy Making Centre	The Specialist Consultant
Shanghai	Commercial Commission of Shanghai Municipal People's Government	The Deputy Director
Beijing	Scottish Trade International	The China Representative
Beijing	Commercial Service, Embassy of USA, China	Two Commercial Assistants
Beijing	Commercial Section, British Embassy	A Senior Commercial Representative

Before going into discussion on the other sources of evidence, the author would like to point out an important issue related to the use of interviews as a source of evidence in case studies. There is a conventional conception that the views given by an interviewee may not be 'true'. However, this does not diminish the significance of the information obtained from interviews in qualitative research, because the main concern of qualitative interviews is to reveal patterns of responses, instead of a set of specific answers to specific questions. Each individual answer, whether true or false, is a piece of that pattern (Piore, 1983). Theories built by using analytic induction "fit" and "work" because they are derived from the concepts and categories used by the economic participants themselves to interpret and organise their worlds" (Jones, 1987:25 in Easterby-Smith, Thorpe and Lowe, 1991:108). Accordingly, the views on the retailing environment in China given by informants of those thirteen companies might not be the 'true' situation, but the main concern of the interviews was to find out a pattern of how these retailers interpreted the foreign direct investment environment in China and how they acted upon it.

Having said the above, nevertheless, interviews with other independent/governmental organisations were carried out, as mentioned earlier, and other sources of evidence were also used in order to corroborate evidence from different sources and achieve a more holistic picture of the subject area being studied.

Documentation

A wide variety of materials, in both English and Chinese, relating to the subject area being studied, were consulted in order to obtain secondary data for the present case studies. These materials include:

- Annual reports of the retailers being studied (various years)
- Company websites of the retailers being studied and some other leading international retailers (constant visits)
- Published information that the author was able to obtain from the companies directly on the Chinese retail operations of those retailers being studied
- Local retail magazines (various issues)
- Research reports on the development of the retail and distribution industry in China by various independent organisations
- Newspapers, both English and Chinese

- Journal and book publications on subjects related to the current study
- Statistical information published, both in hardcopies and on various websites
- Chinese governmental websites on foreign direct investment policies

Direct Observation

Store visits to all the thirteen retailers were made. During these store visits, the author obtained information by direct observation on in-store customer behaviour and other features such as the environment of the store neighbourhood, the physical appearance on the outside of the store, the traffic inside the stores, the physical layout, appearance, and display inside the store, the types and conditions of the merchandise on offer, the staff on the shop-floor, the technology used at checkout points, the store atmosphere and company slogans or other messages displayed in the stores. The store visits to Companies C, F and H were accompanied by the Manager of supermarket division, the Chief Executive Officer, and the Secretary to General Manager of the respective companies. During these three accompanied store visits, apart from the features mentioned earlier, the author was also able to observe the non-sale area of the store, such as storage and reception department, and have inquiries which arose from the observation responded to immediately. On the other hand, the General Manager of the distribution centre of Company L showed the author two warehouses that belonged to their joint venture in China. One was a warehouse for food and non-food products. The other was a warehouse for frozen products. The author was not allowed to take any photos inside the stores or the warehouses. However, notes were written during these visits and some photos were taken on the outside of the stores.

Apart from the stores of the thirteen retailers being studied, the author also visited store outlets of other leading international food retailers and local Chinese food retailers in Beijing, Shanghai, Guangzhou and Shenzhen. The purpose of such store visits was to gain an overview on the differences or similarities between the stores of the retailers being studied and the stores of the others.

4.2 Analysing Qualitative Data

The framework provided by ground theory[12] is employed for data analysis in the present research because it provides an open approach to data analysis that matches the phenomenological background of the research and it is particularly suitable for dealing with transcripts of in-depth interviews (Easterby-Smith, Thorpe and Lowe, 1991). The author would like to stress again that the ultimate goal of the present research project is to advance our theoretical understanding of food retailer's foreign direct investment behaviour by building on their experience rather than slotting their experience into theoretical models derived from work on foreign direct investment in the manufacturing sector. Adopting the analytic-induction approach, the preliminary "working frame" was constantly revised and modified in the course of the research project. According to Easterby-Smith, Thorpe and Lowe (1991), there are seven main stages[13] to an analysis based on the ground theory:

1. Familiarisation
2. Reflection
3. Conceptualisation
4. Cataloguing concepts
5. Recoding
6. Linking
7. Re-evaluation

These seven stages were followed when the author analysed the data obtained for the research project. Analysis of the data and discussion on the issues hence arise is presented in Chapters 5, 6 and 7 that follows.

[12] For more details on ground theory, please refer to Glaser and Strauss (1967), who first formulated the theory; and other scholars, such as Turner (1981, 1983), Mintzberg 1983) and Van Maanen (1983), who have taken the work of Glaser and Strauss further.

[13] For more details on these seven stages, please refer to Easterby-Smith, Thorpe and Lowe (1991:108-112).

Chapter 5 Motives and Processes Behind Retail FDI

Chapter 5

Motives and Processes Behind Retail FDI

Retail internationalisation[1] is by no means a new phenomenon. As early as the first decade of the twentieth century, the Woolworths operation was introduced into the United Kingdom from the United States. European retailers were also instrumental in developing retail structures in Latin America at the same time (Hollander, 1970). Nevertheless, American retailers achieved a significantly higher international profile in the post-1945 environment. The American economy was flourishing in 1950s and 1960s, resulting in a rapid development of retail structure which was in advance of that of Europe (Gomez, 1963 in Akehurst and Alexander, 1995) and Japan (Tanner, 1992 in Akehurst and Alexander, 1995). Retailers from both Japan and Europe, such as Kotobukiya and J. Sainsbury respectively, looked to the United States for inspiration during that period. Because of the innovative nature of retailing in the booming American market, the international expansion of American retail operations had become very pronounced. As a result, most of the early literature on international retailing was based on research carried out in the United States (Akehurst and Alexander, 1995).

An increase in interest by the European retailers in the international environment was witnessed in the 1960s and 1970s (Burt, 1991). Parallel to this development, there was also an upsurge of European studies into retail international activities (Akehurst and Alexander, 1995). However, the 1970s and 1980s saw a slowing of retail activity and international operations in Europe. Some European retailers started to make significant large-scale development in North America in order to escape the less attractive conditions of European retail market (Kacker, 1985 in Akehurst and Alexander, 1995). Alongside this phenomenon, a considerable amount of academic research was dedicated to the international retail dimension on both sides of the Atlantic (Dawson, 1976, 1978, 1979, 1982a, 1982b; Ball, 1980; Waldham, 1978; Goldman, 1981; Martenson, 1981;

Siegle and Handy, 1981; Truitt, 1984; White, 1984 in Akehurst and Alexander, 1995) during that period.

The break down of communist power and the economic transformation in Central and Eastern Europe in the 1980s and 1990s presented the developed world with a place full of potential for development. Retailers from Europe and America gradually went into these transitional economies. This drew the attention of some scholars and studies on international retailing in transitional economies started to emerge (e.g. Fulop, 1991; Loker *et al.*, 1994; Drtina, 1995; Good and Huddleston, 1995; Myers and Alexander, 1997; Sellaro, Maskulka and Burns, 1997; Dawson and Henley, 1998). At the same time, China's economic reform in the late 1980s and 1990s also provided tremendous opportunities for retailers. This also attracted considerable academic interest.

Among the various issues of retail internationalisation that academic researchers have shown interest in, motivations underlying international activities is one popular area. It is recognised that retail internationalisation is initiated and influenced by the complex interplay of both exogenous and endogenous factors to a retail firm. With the continuous change in the international retail environment and the advancement of management structure of firms, it is believed that the motives for internationalisation change over time because internationalisation behaviour is embedded in context in terms of time, scale and geographical orientation (Alexander, 1995a; Clarke and Rimmer, 1997; Quinn, 1999). As mentioned earlier, the emergence of the transitional economies in Central and Eastern Europe and China in the last two decades is unprecedented. Against this context, the research on motivation that was conducted with firms going into developed countries in the past might not be appropriate to explain the foreign direct investment of retail firms in the transitional economies nowadays.

[1] Retail internationalisation, in this thesis, is defined as the process that a retail firm establishes retail operations in a foreign country.

This chapter is devoted to investigation of motives underlying foreign direct investment activities of food retailers. The reasons why they expanded into China are also studied. The chapter also examines the process of internationalisation of some leading retailers by looking at the chronological and geographical sequences of their expansions. For each of these three areas, the findings from the empirical work are discussed in the light of the existing knowledge in the field.

5.1 Motivation

5.1.1 Existing Research on Retail Internationalisation Motives

Hollander's work in 1970 is always regarded as the starting point for the study of retail internationalisation motives. He classifies the motives into three categories: inadvertent, profit oriented and non-commercial (i.e. social, political, personal and ethical). He also advocates the concept of reactive and proactive internationalisation. The former occurs when saturation in domestic markets becomes the key consideration on a retailer's decision to expand overseas. The latter occurs when a retailer decides to venture abroad before its domestic market is saturated. A lot of the subsequent studies centre on promoting either of these two poles in the internationalisation process with the majority arguing that internationalisation is primarily a reaction to limited opportunities in the home market.

The 1980s saw the development of the 'push' and 'pull' groupings as the approach towards explaining retailers' internationalisation activities. Kacker (1986) discusses the push factors of European environment and the pull factors of the US economies in his study on the motives behind the expansion of European retailers to the US during the first half of the 1980s. Treadgold and Davies (1989) also categorise the motives into the push and pull groups. Other studies supporting the same theme include the work of Treadgold in 1990 and Alexander in the same year. All these studies recognise more importance on push factors than pull factors.

Apart from the discussion of push and pull factors and the reactive versus proactive grouping, Treadgold (1988) further proposes that retailers can be classified according to their internationalisation strategies into four categories, namely 'the cautious internationalists', 'the emboldened internationalists', 'the aggressive internationalists', and 'the world powers'. Laulajainen (1991), in his case studies on Toys'R'Us and IKEA, highlights the importance of 'cultural closeness' in the discussion of pull factors. In the same case studies, he also found that the first foreign entries were undertaken before saturation was reached in the domestic market and hence suggests that push factors do not always play a more important role than pull factors in retail internationalisation. Firms can be quite proactive. This poses a challenge to the prevailing belief that retailers are basically reluctant to go abroad unless they are pushed by some unfavourable factors in their domestic markets. Having a similar doubt about the simplistic push and pull dichotomies, Williams (1992a, 1992b) conducted a survey on motives of internationalisation of 61 UK retailers who operated at least one outlet (company owned, franchised or an in-store concession) both within and outside the UK. His conclusion is that retail internationalisation motives are more complex than the previous push and pull grouping. Low regard for motives based on perceived limited domestic market growth opportunities was found. In contrast, growth oriented motives and those arising from an internationally appealing and innovative retail offering were seen as significantly more important in the retailers' decision making process. Therefore, Williams claims that 'retail internationalisation has preference to domestic expansion' (1992a: 278). Because of the difference in his conclusion regarding motives of internationalisation to those offered in the past studies, he further suggests that 'motives of retail internationalisation may depend and vary across markets and operating environments' (1992a: 279).

Most of the research on retail internationalisation conducted after 1992 appears to merely acknowledge the past research on motivation without further adding onto the debate mentioned above, because they shifted their focus on other issues involved in retail internationalisation. Examples of these issues include growth strategies (Pellegrini, 1994), market entry mechanisms (Dawson, 1994b), preconditions for successful retail internationalisation (Simpson and Thorpe, 1995), cultural issues (Dupuis and Prime, 1996; Helfferich, Hinfelaar and Kasper, 1997), strategic decision making process (Clarke and Rimmer, 1997), and attempts of reconciling the eclectic paradigm of Dunning (1993) with retail internationalisation (Pellegrini, 1991; Dawson, 1994b). In most of these studies, motivations of cross border retail expansion were briefly reviewed. The contradictory nature of the results from the previous researches mentioned earlier was reduced into a 'checklist' of motivations behind retail internationalisation, which combines all the motives that have been put forward by different studies. The driving forces predominantly present in the 'checklist' are as follows:

- Various growth-related motives, when internationalisation is a means to increase sales and profits, expansion into underdeveloped markets with higher growth rates, and when expansion goals cannot be achieved domestically;
- limited opportunities for growth in retailers' home markets due to market maturity, saturation and dominance, increased competition, exhausted or unsuitable diversification prospects and excessive regulations;
- motives derived from an internationally appealing and innovative retail concept;
- various reactive and subjective motives including imitating competitors, responding to offers from foreign retailers, surplus resources and depressed share prices, and responding to inducement/encouragement by manufacturer-supplies wishing to enter new market;
- motivations related to the transfer of retail know-how and techniques, senior management drive and economies of scale.

Having said that the debate on whether proactive elements or reactive elements play a more influential role in retailers' moves overseas was not rigorously carried on, however, there has been gradual recognition on the proactive elements underlying retail internationalisation and on the importance of the wider socio-economic and commercial environment in which retail internationalisation is embedded (Alexander, 1995a; Burt, 1993).

In 1999, Quinn saw the lack of empirical research into the decision-makers' perception of the initial move overseas with the consideration of the operating conditions prevalent at the time of the initial expansion. Therefore, he decided to re-examine the motives for retail internationalisation using a survey of UK retailers with international retailing operations. His results showed that UK retailers were strongly influenced by growth oriented or other proactive factors in their decision to internationalise.

Furthermore, he asserts that the conflict in opinion on the motives for retail internationalisation in the literature revolves around methodological, spatial and temporal issues. First, different researchers employ different methodological approaches. The reactive school adopts a tracking approach based mainly on secondary data. In contrast, the proactive school employs an empirical approach and mostly quantitative research techniques. Therefore the two schools have different assumptions. The former bases their assumptions on observed activity whereas the latter evaluates the opinions of those directly involved in the internationalisation process. Secondly, in terms of the spatial issue, the reactive school undertakes a more universal view of the process while the proactive school focuses its research on the activities of UK retailers only. Thirdly, the socio-economic and commercial environments from which the research of the two schools emerges are very different. The research conducted by the reactive school was undertaken against the background of wider economic, social, political and retail specific conditions evident in the early to mid 1980s. Their observations were acceptable in that national retailers were confronting limited opportunities in their domestic market and hence perceiving overseas markets as a means by which their growth could be sustained. On the contrary, the subsequent studies carried out by the proactive school were conducted in the late 1980s, a period with a relatively stronger economic climate in Europe. Furthermore, those studies focused on UK retailers who were taking a more proactive role in the distribution channel. Consequently, it could be argued that UK retailers in the late 1980s pursued overseas expansion more actively, regardless of the situation of their home market.

As mentioned at the beginning, retail expansion into transitional economies has become increasingly popular in the 1990s. The trading conditions that international retailers face in this context are different from the situation that has been discussed widely in the retail internationalisation literature in the past. Alongside the changing socio-economic and commercial conditions in the transitional economies, a high concentration of retail firms in Europe, high closure rates and return to the respectability of price competition in the UK is witnessed (Quinn, 1999). This worldwide changing socio-economic and commercial climate provides a valuable opportunity to reassess the nature and intensity of the motivations behind the contemporary expansions of retailers into the transitional markets.

5.1.2 The Empirical Results

During in-depth interviews, top executives of the foreign side of the food retail joint ventures in China were asked to explain why their companies had gone abroad and have to keep internationalising. These were meant to be open-ended questions. Interviewees were requested to elaborate as much as possible. The author did not offer any suggestion on different motives to the interviewees so that the original views of the interviewees on their retail expansions could be best captured. The explanations on motives behind their internationalisation provided by different retailers were then compared and sorted for further analysis. It has to be noted that one of the 13 retailers being studied did not offer any comments on the questions regarding motives behind internationalisation because the interviewees of this company claimed that they were not in a position to talk about it. Therefore, there are only 12 retailers available for the analysis of this issue.

On the other hand, secondary sources were also consulted in order to trace the internationalisation history of the companies. This procedure was done to investigate whether there is any pattern or stages of internationalisation of the companies being studied. Secondary sources were also important in that information on the wider socio-economic and political background alongside retail internationalisation is needed for a more comprehensive understanding on the driving forces underlying retail internationalisation.

When the subjects were asked to express their views on why their companies need to internationalise, four out of the 12 food retailers perceived growth in scale, so that they could have bigger bargaining power over suppliers, to be the most important reason for their international expansion. Three of them are European retailers and the other is from Japan. These three European retailers also mentioned that growth in market share is of equal weight as growth in scale because it is necessary to keep growing in market share in order to avoid being 'eaten up' by competitors. One of these three European retailers claimed that accumulation of 'know-how power', meaning knowledge on different markets in the world and hence management know-how and retail operation techniques, is also a main reason for them to expand overseas.

On the other hand, another European retailer expressed that growth in profits is the biggest drive for them to go overseas. From this retailer's point of view, national boundaries render no confines to their business domain. It is a borderless world to them and they actively look for and operate in places where opportunities to make money exist. They further commented that domestic market saturation forced a lot of retailers to go abroad but their overseas expansion was never driven by it. The Japanese retailer whose expansion was mainly caused by the desire to increase bargaining power over suppliers had a similar view on saturation. They stated that saturation is only a minor force that made them undertake foreign direct investment. The desire to grow in profits was also named by two other European retailers but instead of being the biggest driving force, they commented that it was only the secondary important factor, although they shared the perception that their home countries were too small in a world scale for making money.

Another four out of the 12 retailers pointed out that it was the saturation at their home markets that triggered their moves beyond their home countries. Three Hong Kong retailers and one from Japan make up these four retailers. One of these Hong Kong retailers revealed that growth in market share to avoid being 'eaten up' and growth in scale for bigger purchasing power were also very critical factors causing them to become involved in foreign direct investment. It has to be noted that the other two Hong Kong retailers do not have any food retail operation outside Hong Kong and China. The Japanese retailer who thought saturation was the main reason behind its internationalisation mentioned that alongside saturation of the Japanese market, there was also the desire to grow in profit and Japan is too small a market for making huge profits in the world scale.

Search for an international image, in Tordjman and Dionisio's (1991) term, was alleged by the other three retailers, one Japanese, one Taiwanese and one American, as the paramount reason for their internationalisation activities. They have a strong desire to obtain an image of being a significant food retailer worldwide.

5.1.3 Discussion

At first glance, the motives underlying retail internationalisation given by the twelve food retailers are more or less the same as those that had been proposed in the literature before. Consequently, it is very tempting to claim that the explanation on motives for internationalisation provided by the existing literature is applicable to the case of foreign food retailing in China, which is an economy in transition. However, the various motivations mentioned in the last section should not be treated discretely. It would be imprudent to extract key phrases from the interviewees' responses and match them with the existing categories being offered in the literature, which were mainly obtained from either questionnaire survey or analysis using secondary data, to arrive at a conclusion about the most important driving force behind food retailers' internationalisation activities. It is because under scrutiny, there are linkages between the different motives mentioned by the interviewees that give the holistic perspective of the rationale of food retailers for extending their business domains overseas. This issue, therefore, will be examined in detail later, in the light of the elaborate and in-depth discussions with the twelve food retailers and the existing literature.

5.1.3.1 Reactive International Expansion

Reactive international expansion is related to market saturation and dominance, intense competition, exhausted or unsuitable diversification possibilities and excessive regulation constraining growth of business in the domestic market (Williams, 1992a, 1992b; Clarke and Rimmer, 1997). These factors are named push factors as mentioned earlier. The use of push factors as the explanation of retail internationalisation was most prominent when academic research interest was focused on the cross border retail activities between the two sides of the Atlantic Ocean in 1980s.

Wider Economic Performance and Legal Constraints

Both Kacker (1986) and Treadgold (1988) believe that European retailers were pressured by the unfavourable environmental condition at that period. Continental Europe in the 1970s and early 1980s was characterised by a relatively flat economic performance and population growth. It experienced a relatively high inflation rate and unemployment. In Belgium, France, the Netherlands and West Germany, there were planning policies and procedures, including stiff land use planning, aiming to restrict large store developments in terms of new openings of stores and acquisitions. As a result, European retailers were pushed to expand into the US market that had steadily growing economic performance, less regulation on store development and unabated appreciation of real estate.

This argument is overthrown by Burt (1991) even though he is aware that a number of French retailers have publicly mentioned the 1973 Loi Royer as a motivating factor searching for opportunity outside France. He argues that French expansion overseas was already underway before the Loi Royer began to take effect. Eight French companies had already initiated overseas activities by 1974 and there was no further move by another major French player until 1981. At the same time, the German retailers Albrecht, Tengelmann and Hugo Mann had undertaken international investments before the large store legislation was tightened in 1978. Tengelmann had gained international experience from its foreign investment in Austria in the early 1970s. As a limited-line discount chain store, Albrecht would not have been affected by the legislation. Therefore, Burt claims that it is not justifiable to attribute the temporal trends of retail internationalisation to the individual pieces of legislation.

Market Saturation

Apart from the wider economic performance and legal constraints, another push factor that is also strongly put forward is market saturation. However, there is a lack of discussion on the concept of saturation in the retailing literature in spite of Treadgold's (1988) effort in pointing out the ambiguity of the meaning of market saturation.

According to Treadgold (1988), increasing retail floor-space had been the traditional strategy for retail expansion during the post-war period. This approach, however, had gradually lost its popularity and had slowly become an unavailable option. It had been progressively realised that there is an upper limit to the number of large new store openings that can be supported by the expected future consumer demand within any one geographical boundary. This phenomenon is termed 'market saturation'. Treadgold (1988) asserts that the concept of saturation is highly complicated. He claims that intuitively, there must be a ceiling to the amount of retail floor-space that can be supported before diminishing returns start to take effect and profit per unit begins to decrease. However, it is problematic to find an appropriate indicator of the onset of saturation. Any attempt to predict with 'an acceptable degree of precision when this point of diminishing returns is reached is obviously extremely hazardous' (Treadgold, 1988:9). The critical point is dynamic in that there are many different variables used to determine the onset of diminishing returns on retail investment and those variables themselves are subject to change. This view is also shared by Laulajainen (1991). Therefore, it can only be said that any such point of diminishing returns is moving everfurther forward as a result of rising price of real estate and increasing difficulty in obtaining new store development permission.

Following Treadgold's argument, it is impossible to determine whether a market is saturated or not in an objective and absolute term. When academic scholars or retailers claim that a certain market is saturated, they are only expressing their perceptions on the outlook of the market in terms of the possibility that retailers could further expand their floor-space without having diminishing returns on their retail investment. According to the reactive school, retail internationalisation is a reaction of retailers to market saturation in their domestic market. If this claim is valid, retailers should make no further investment in their home market once they decide to go abroad. However, empirical evidence shows that this is not the case.

All of the companies being studied in the present research and other international food retailers continue to invest and expand in their domestic markets while they are simultaneously engaged in overseas operations. Wal-Mart is one example[2]. Wal-Mart started going abroad in 1991. Since then, it has been expanding to different countries such as Canada, Argentina, Brazil, China, Germany, Korea and the United Kingdom. While it keeps exploring new geographical domain abroad, it does not cease to give attention to its business in the domestic market. For example, in concert with the opening of two new stores in Brazil, two in China, two in Mexico and four in the United Kingdom during the first quarter of 2000, it also opened seven discount stores and 32 supercentres in the US in the same period. Promodès, which has now merged with Carrefour, continued to plan for new stores while it kept internationalising[3]. The same phenomenon is also witnessed in other international food retailers such as Carrefour, Ahold, and Dairy Farm[4]. Europe is always perceived as a saturated market with very intense competition. However, none of the European retailers interviewed have desisted

[2] Annual reports of Wal-Mart
[3] Annual reports of Promodès
[4] Annual reports of various international food retailers

from pursuing domestic growth. Nor have their counterparts in Hong Kong, which is also perceived as a highly saturated market.

The Case of Hong Kong Food Retailers[5]

Market saturation was mentioned as the main reason by the Hong Kong food retailers for their foreign investments in China. Apart from these respondents and one from Japan, who made the same claim, none of the other respondents mentioned this reason during the discussion of their motivation for going abroad. Nevertheless, this result does not necessarily imply that the Hong Kong food retailers were 'pushed' by the unfavourable conditions in their home market.

Supermarkets were introduced into Hong Kong in the early 1960s. Dairy Farm acquired the Wellcome grocery chain in 1964 and this marked the beginning of a well-organised development of supermarket industry in Hong Kong. The other dominant supermarket chain in Hong Kong is Park'N Shop, which belongs to the Hutchison Whampoa group. It started operating the Park'N Shop chain in 1973. Wellcome and Park'N Shop are the two major food retailing players in Hong Kong.

After more than three decades of development in a well-developed economy, supermarkets in Hong Kong are still unable to dominate the food market. The food retail sales by supermarkets and hypermarkets in the 1998 were 5 567 and 695 million US dollars respectively[6]. They together account for 51% of the total food retail sales in that year. In other words, the supermarket and hypermarket sector managed to capture just over half of the food purchases in Hong Kong in 1998. The other half of the food market was served by the traditional food-retailing sector, which includes the 'wet-market', independent grocery stores, bakeries, Chinese foods stores and street hawkers. There

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[5] Unless stated otherwise, source of information in the cases: various annual reports of Dairy Farm and Hutchison Whampoa Limited.

[6] Source: Euromonitor. 2000c. *International Marketing Data and Statistics 2000*. London: Euromonitor plc.

were 1 281 supermarket and hypermarket outlets in the same year[7]. Given the population size of 7 million[8], the per capita level of supermarket provision in Hong Kong was similar to that of France, which has a population size of 59 million[9] and 8 131 supermarket outlets[10].

Real estate is very expensive in Hong Kong and space is very limited. As mentioned before, Wellcome and Park'N Shop have always been the two major players in the supermarket industry in Hong Kong since the introduction of supermarkets dated back to more than 30 years ago. These, together with the statistics presented in the last paragraph, indicate that there is very intense head-on competition and this may give an impression that Hong Kong is a very 'saturated' market for food retailing. Considering this environment and the explicit claim of those respondents with a Hong Kong origin, regarding motivation behind internationalisation, it is very tempting to conclude with a verdict that follows the reactive school. Such a conclusion, however, will not be reached when the internationalisation history of those retailers is taken into account.

Dairy Farm's food retail operation first went beyond Hong Kong in 1979 by acquiring the No Frills chain in Australia. Since then, it has continued to extend its business domain to the UK and Taiwan (in 1987), New Zealand and Spain (in 1990), China (in 1992), Singapore (in 1993), Malaysia (in 1994), India, Indonesia and Japan (in 1995). Although it has discontinued its business in the UK, Spain and Japan, its number of outlets in all the other countries, including Hong Kong, has been increasing throughout all these years. Dairy Farm's mission is to be the leading food and drugstore retailer in the Asia-Pacific region as well as "to ensure Dairy Farm stays on top of Hong Kong supermarket industry"[11]. Due to intense competition between Dairy Farm and the

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[7] Source: Euromonitor. 2000c. *International Marketing Data and Statistics 2000*. London: Euromonitor plc.
[8] Source: World Bank. 2000c. *Entering the 21st Century: World Development Report 1999/2000*. New York: Oxford University Press.
[9] Source: World Bank. 2000c. *Entering the 21st Century: World Development Report 1999/2000*. New York: Oxford University Press.
[10] Source: Euromonitor. 2000b. *European Marketing Data and Statistics 2000*. London: Euromonitor plc.
[11] Source: www.dairyfarmgroup.com/dfarm_graphic/operations/com.html.

traditional food retailers as well as between Dairy Farm and Park'N Shop, Dairy Farm and Park'N Shop have always been looking for new strategies in the hope that they could capture more market share in Hong Kong. In 1998, Park'N Shop started to introduce the 'wet market' into their Hong Kong outlets and they started to build outlets with larger floor space, which then were named 'superstores'. By so doing, they expected that they would attract customers from the 'wet market'. At the same time, Wellcome also adopted a certain strategy for capturing more fresh food customers. They opened a US$50 million Wellcome Fresh Food Processing Centre in November 1998. Since then, competition between the two companies has become increasingly fierce. A price war was started in August 1999 and continued into 2000. Nevertheless, Wellcome claimed that they managed to maintain their market share.

Wellcome's behaviour in Hong Kong described above contradicts the tenet of the reactive school. They have never been 'pushed' out of Hong Kong by the unfavourable operating environment there. Even in 2000 when the competition has further escalated, they are still very active in terms of investment and remains ambitious in the Hong Kong market. It has always been looking for growth in size in both Hong Kong and abroad. Accordingly, it is difficult to believe that Dairy Farm's engagement in foreign investment is due to the limited growth opportunities in the so-perceived 'saturated' Hong Kong market.

On the other hand, the story of Park'N Shop also adds some interesting arguments to the debate. The history of Park'N Shop is different from that of Wellcome. As mentioned earlier, Park'N Shop is a business segment of Hutchison Whampoa Limited. Unlike Dairy Farm, which is a retail business entity, Hutchison Whampoa Limited is a business conglomerate consisting of a wide variety of different businesses, such as telecommunication, retailing, manufacturing, real estates, just to name a few. Its progenitor was a dock company. Therefore, retailing is just one of the many different businesses of the group. Nevertheless, the company root was related to retailing. A S Watson, a drug store, was opened in Guangzhou, China in 1828 and this was the first event in the group's history. A S Watson extended its operation to Hong Kong in 1841. As time went, the group was slowly formed. In 1973, the group acquired Park'N Shop supermarkets. Since then, Park'N Shop has been operating as one the of the leading supermarket chains in Hong Kong. Park'N Shop opened its first outlet in Mainland China in 1984, which was eight years before foreign direct investment in retailing was allowed in China. Despite the group has businesses overseas, Park'N Shop only operates in Hong Kong and Mainland China. This is interesting behaviour as given the intense competition and market saturation in Hong Kong, Park'N Shop should vest more attention abroad to look for more growth opportunities when its group has already had experience in countries other than Hong Kong. Contrasting this expectation, Park'N Shop has always been only concentrating its business in Hong Kong and China and has never ceased investing in its operation in Hong Kong.

Based on this example, it is believed that unfavourable domestic market conditions such as intense competition do not necessarily 'push' retailers to internationalise. In fact, Burt (1991) has made similar assertion. He observed that the grocery retail market in the UK was already highly concentrated in the 1970s and 1980s. However, the major grocery retailers in the UK have hardly undertaken an aggressive internationalisation strategy during that period.

Given the above arguments and illustrations, the reactive school doctrine is difficult to vindicate. 'Internationalisation [in retailing] is an "and" to domestic growth not an "or"' (Dawson, 1999b:5). The reason for food retailers pursuing internationalisation is more complicated than the reactive school suggests.

5.1.3.2 Proactive International Expansion

Following the above argument, if retailers are not 'pushed' by the unfavourable conditions in domestic markets, they must be rather proactive in their internationalisation activities. In fact, the empirical work of Alexander (1990) and Williams (1992a, 1992b), which was carried out in the late 1980s and early 1990s on both sides of the Atlantic, suggested that retailers were growth oriented and proactively looking for internationally appealing and innovative offering. Their respondents were more inclined to stress their proactive responses to the international environment and they attached relatively insignificant importance to issues such as domestic market saturation. They identify opportunities continuously and internationalise accordingly instead of waiting for limited opportunities in their domestic market to trigger their expansion abroad. A similar result was obtained from the empirical work of the present study.

Ten out of the 13 respondents claimed that the motives behind their internationalisation were related to survival and growth. Apart from the three Hong Kong retailers and one Japanese retailer, who talked about the unfavourable condition in their home market, (discussed in the previous section), all of the others put much emphasis on the importance of continuous expansion, disregarding geographical boundaries. Six retailers even explicitly stressed that they were rather proactive in terms of internationalisation, in that they started engaging in foreign operations before their domestic market had become saturated. Four of these six retailers are from Europe and the other two are from Asia.

The Case of Company F

Company F, which is one of those four European retailers, went abroad in 1968, which was almost 25 years before the unification of the European market. It was a time long before there was an integrated retailing market and an integrated distribution structure in Europe. It was also a time well before there was 'domestic market saturation' in Company F's opinion. Since then, it has become established in a number of European countries and China. 'Because of their entrepreneurial style and vision', it managed to learn about those foreign markets very quickly and its business started flourishing soon after its entrance to those markets. It claimed that it always occupied a top position in the retailing sector in all those countries in which it was present. It believed that the situation in its domestic market today, where there is a population of 80 million people and Company F has 55 outlets, confirmed that its vision to expand overseas 30 years ago was 'very wise'[12]. The Chief Operating Officer added that

> "I personally believe...(that) we have to proactively spot opportunities and go to countries (other than our own) where we could make money out of our profession before one gets stuck in its own domestic market."

The Case of Company D

A similar attitude was found with Company D, which is also a European retailer. The President of the company expressed that

> "...the reason why you find us all over the world is that in order to be successful, to be prosperous, we have no choice but to find opportunities around the world...We internationalised because of the vision of the owner. They set up the whole chain. They looked at the world, not just at our domestic country, and they saw where opportunities were going to arise. So our company has been in Asia for over 10 years now...To do with the more positive side, they took decisions that they would pioneer. They were the first to come into Asia, when other people were only thinking about it. And we are successful...Europe was not saturated at the time when our owner made the decision to go to South America and Asia...The world is moving and the market is moving with regard to opportunities. So, our company is totally entrepreneurial. We put money into Asia because we saw the opportunities whereas a lot of other people only came to Asia to look for a solution for the problem of market saturation in Europe at a much later time."

The Case of Company I and The Other Two Asian Retailers

A further look at the history of those proactive European retailers reveals that Company I also internationalised at quite an early time. It did so 30 years ago when it already realised that their domestic market would be too small on a world scale as globalisation would gradually become the world climate for businesses in general. The two Asian retailers do not have such a long history of internationalisation but they share a similar attitude. With their entrepreneurial proactive attitude towards internationalisation, they are continuously assessing opportunities in different markets and are waiting for the

[12] Source: Interview with Company F.

arrival of the 'right environment'[13] and liberalisation of policy towards foreign direct investment in the markets they are interested in so that they could enter those markets.

The above examples lend support to the proactive school and add to their strength by providing vivid and detailed accounts made by the interviewed retailers on the issue of motivation behind retail internationalisation. The contribution of the present empirical work, nevertheless, does not end at this point. What the proactive school fails to address with enough emphasis is the ultimate reasons of why retailers have to proactively internationalise. The major reasons existing in the proactive school literature are the existence of favourable conditions at host markets, possession of some competitive advantages, economy of scale, enhancement of company image, managerial commitment, gaining access to new capital source and realisation of monopolistic profit. These reasons are never discussed in detail and they are only offered as a list of the various reasons that are of equal significance. In fact, many of the reasons presented in the literature were not mentioned at all during the author's interviews with the food retailers[14]. The divergence of the results between the past research and the present study is believed to be due to the difference in methodology. The mainstream proactive school empirical work adopted the survey method (for example: Alexander, 1990; Williams, 1992a, 1992b; Quinn, 1999). Top executives in retail companies were given a list of motives and they were asked to weigh the importance of each of them. In other words, several different motives were already assumed before the empirical work was conducted. This way, the empirical work could only identify the different degree of importance of each of the suggested 'motives'. On the contrary, the present study adopted in-depth interviews with retailers using open-ended questions. When asked about the reasons why their companies had to engage in foreign operations, no reasons were suggested by the author. The interviewees' responses, therefore, represented entirely their own views and are believed to be the ultimate reasons behind retail internationalisation. Nevertheless, this does not mean that the results obtained by the

[13] The 'right environment' here means the economic performance and infrastructure that a retailer considers crucial for their business to be able to survive.

past research should be overthrown. Instead, it is argued that some of the reasons offered in the past are only the more immediate reasons rather than the root causes of retail internationalisation; and some of them, such as the possession of certain competitive advantages, are more inclined to be the prerequisites for successful foreign direct investment rather than causing international moves. The ultimate motives behind retail internationalisation, based on the empirical work, will be discussed as follows.

5.1.3.3 Market Power

According to Wilemon (1972 in Gaski, 1984), the marketing definition of power is the ability of one channel member to induce another channel member to change its behaviour in favour of the objectives of the channel member who is exerting the influence.

Food retailers are proactive in internationalising because, as the empirical work suggested, it is necessary for them to keep growing in scale in order to pre-empt their counterparts from 'swallowing' them through mergers and acquisitions and to obtain bigger bargaining power against their suppliers. This point is well illustrated in the claim made by the General Manager of Company K,

> "If you don't keep growing, you will be eaten up by the others, because market share and buying power are far more the most important in this business (of food retailing)."

The continuous extension of market power both horizontally and vertically is essential for retailers' survival.

In fact, Hymer, in as early as 1960 in his PhD thesis, advocated that foreign direct investment is a means by which producers extend their market power[15]. Firms are tempted by the powerful incentive offered by the possibility of monopoly to pursue "continuous and unlimited" (Knight, 1933 in Coase, 1937: 394) expansion, even at the

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[14] The reasons behind retail internationalisation given by the food retailers were shown in section 5.1.2.

[15] A more detail discussion on Hymer's market power thesis, including a definition of the term 'market power', is given in the Chapter 2.

expense of losing efficiency. The relationship between efficiency and size is primarily a matter of "personality and historical accident rather than of intelligible general principles" (Knight, 1933 in Coase, 1937: 394). This assertion is particularly pertinent to the food retailing industry. In the context of retailing and wholesaling, competitiveness of a firm is defined by its share of a market and its ability to transfer its retail or wholesale concept to other countries (Dawson, 1999a). In other words, retail firms always strive to continuously increase its share in a market and expand the geographical domain of its business in order to remain competitive in the marketplace, or more precisely, to remove competition from its rivals. Cross border activities are especially important for the survival of a food retailer because of a number of social, economic, political and technological changes in the last two decades or so. The world trade regime has been increasingly liberalised. The number of countries in the World Trade Organisation membership is increasing. Policies such as the free trade policy facilitate global business dealings. Restrictions on currency convertibility, exchange control, stock exchange access and repatriation of capital have been largely loosened. All these changes, when coupled with differential tax rate and taxation policy in different countries, rapid advancement in telecommunication technology and deregulation in the retail and distribution industry, render that national boundaries provide no shelters to the local retailers. As a result, retailers are increasingly competing with one another in a global scale instead of on a national level. The mergers and acquisitions and alliances of various forms between retailers from different countries are indication of the borderless nature of retailing in the contemporary era.

'Horizontal' Market Power

'Horizontal' market power in this research is defined as the ability of a food retailer to dominate the consumer market of food. As mentioned before, three out of the four European retailers stated that the major motive for their internationalisation was the need to grow in size in order to avoid being 'eaten up' by their competitors. One out of the three Hong Kong retailers also believed that this is an important reason for its overseas operation. Driven by the desire of obtaining monopoly profit, firms continuously pursue expansion. Mergers and acquisitions, when compared to organic growth, serves as a means by which extra market power can be acquired in the shortest time. In this process, the original identity of the firm being acquired will 'disappear'. Or, even in the case that the name of the acquired company is retained, the acquired company will lose the majority shareholding status and hence lose the ultimate control. In order to remain as a dominant player and to maintain control of their companies, retailers endeavour to increase their horizontal market power. In other words, retailers strive for growth in horizontal market power to avoid being 'swallowed' and internationalisation is perceived as an important way to achieve this. When asked about why their company needed to internationalise, the chief food-purchasing officer of Company F pointed out,

> "...the whole system is built on growth. You need to grow in terms of mass, turnover and power. Otherwise, you will be eaten by competitors."

Mergers and acquisitions in the retailing sector are not a contemporary phenomenon. However, those occurring in recent years are creating intensifying tensions between the existing players. Reynolds (1999) warns that European retailers are no longer safeguarded from large-scale globalisation and size does matter for food retailing. "The Wal-Mart acquisition of (the British retailer) Asda has sent shock waves throughout the food retailing sector (in Europe)" (Hubbard, 1999). The arrival of this world's largest retailer (with an American origin) into Germany in January 1998 and the UK in July 1999 has pressurised firms across the retail spectrum to envisage non-domestic threat (Vaughan, 1999).

In fact, there had already been strong pressure from competition in the retailing sector in Europe before the 'intrusion' of Wal-Mart. Concentration is witnessed in the food sector in all the Western European countries and the tendency is further increasing. In 1991, the top five food retailing groups accounted for more than 45% of the British market, 40% of the French market, 12% of the Spanish market and 20% of the Italian market (Tordjman, 1995). In 1998, these ratios have increased to 67%, 67%, 38% and 30% respectively (Dobson Consulting, 1999). The small retailers had been driven out of business by the big retailers (Tordjman, 1995) and nowadays even the remaining big retailers are experiencing very intense competition. The acquisition of Asda by Wal-Mart posed a serious threat to the major retailers in Britain, including Sainsbury, Tesco and Safeway, and resulted in a cut-throat price war immediately after the acquisition. Soon after this significant acquisition, there came another attention-catching event in August 1999. This time, it was a deal between two French retailers. Carrefour proposed the largest acquisition in retail history with an offer of US$16.6 billion for Promodes. Management Venture, Inc. (2000) believes that it marked the first of several large-scale European consolidations that would take place in the following one or two years. After the acquisition, Carrefour has become the world's second largest retailer after Wal-Mart, with consolidated sales reaching US$65 billion by the end of 1999. It is postulated that this acquisition will exert a considerable amount of pressure on other key retailers such as Wal-Mart, Auchan, Ahold, Metro and Tesco (Management Venture, Inc., 2000).

The threat of being acquired does not only affect the players within the European market. Retailers in other parts of the world are also affected in a similar manner. For example, Asian retailers are also confronted with competition, both existing and potential, from the international retailers with a European origin when the European retailers have operations in both the domestic and host countries of the Asian retailers. In the same vein, any Asian retailer could become the target of acquisition by European retailers. For instance, the retailing business of the CP Group, which has a Thai origin, was partly purchased by Tesco, which is a British food retailer, in 1999. In fact, it is the middle size players who are the most vulnerable under the consolidation trend. Hubbard (1999) asserts that consolidation in the food retailing industry is going to exert considerable squeeze to the middle size food retailers and might prove fatal to them. Wal-mart and key European food retailers are ranked as the top food retailers in the world. Asian retailers are not comparable to them in capital, size and turnover. For example, the total sales of Wal-Mart for the fiscal year ended 31 January 2000 was US$165 billion; that of Ahold for the year 1999 was about US$30 billion; that of Carrefour for the year 1999 was also about US$30 billion; that of Makro Asia for the year 1999 was about US$3.7 billion; that of Ito-Yokado Superstore for the fiscal year ended 29 February 2000 was US$12 billion; and that of Dairy Farm for the year 1999 was US$6.8 billion[16]. Furthermore, the best target to be taken over would be those retailers who have strong market share in a country where the acquirer desires to aggressively enter and have simple company structure in the sense that they do not have extensive international spread. Many key Asian food retailers, who are not as internationalised as their key European counterparts, therefore, fall into the category of desirable acquirees in the global game of mergers and acquisitions. As a result, these Asian food retailers also strive to increase their market power by continuously increasing their size, turnover and presence in different countries in order to survive. This point is best illustrated by the comment of the Director of China Development of Company A, a Hong Kong retailer,

> "You may have noticed the M & A deals in the retail sector recently. Even some sizeable players have found difficulties to continue their growth at the historical pace...A natural move is to put more attention to overseas markets for opportunities in development and acquisition. While the major competitions are expanding, it becomes a matter of survival to keep growing to maintain the size and economy of scale. Life will be more and more difficult for some operators."

Based on the discussion in the last few paragraphs, it is evidenced that food retailers are strongly inclined to pursue international expansions in order to go beyond the size and the complexity of their company structures in terms of international spread at which take-over would be a threat. It has to be noted that the speed at which a company can grow by organic growth will logically be lower than the speed at which a potential take over can be realised. Retailers are aware of this fact. Therefore, food retailers do not expand only by undertaking foreign direct investment but also by mergers and acquisitions at the same time if possible. Nevertheless, mergers and acquisitions are not an 'easier' option against foreign direct investment because the possibility of making a take-over depends on a lot of factors, such as the capital strength of the retailer and the availability of suitable acquirees. This is especially true to the cases of emerging

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[16] Sources: Annual reports of the mentioned companies

markets, such as China and Central and Eastern Europe. In those markets, there are not many existing chains that are suitable to be acquired[17]. In fact, 55 percent of international retailers prefer organic growth strategies (White, 1995 in Helfferich, Hinfelaar and Kasper, 1997). Consequently, foreign direct investment still serves to be a means of paramount importance by which food retailers could achieve continuous growth that would auspiciously protect them from being 'swallowed' by their competitors.

'Vertical' Market Power

As mentioned earlier, the need for retailers to grow in size and international spread is due to two main reasons. One is the need to gain 'horizontal' market power, which has just been discussed; and the other is the need to achieve 'vertical' market power, which will be investigated in this section. 'Vertical' market power in this research refers to the ability of a food retailer to dominate the supplier market. In other words, it is the bargaining power of retailers over their suppliers. A more precise definition of buyer power in the context of retailing is given by the Committee of Experts on Restrictive Business Practices in their 1981 report. Buyer power is perceived as "a situation which exists when a firm or a group of firms, either because it has a dominant position as a purchaser of a product or service or because it has strategic or leverage advantages as a result of its size or other characteristics, is able to obtain from a supplier more favourable terms than those available to other buyers" (OECD, 1981 in Dobson Consulting, 1999). Accordingly, a retailer is perceived to have buyer power when it has a dominant position in the supplier market and it uses this to extract favourable prices and other terms and conditions from suppliers.

Three out of the four European retailers suggested that bargaining power is the other ultimate reason, which is of equal importance as the horizontal market power, underlying their internationalisation. One out of the three Hong Kong retailers also

[17] Further discussion on this area of mergers and acquisitions will not be made because this is out of the scope of the present study.

believed that this is an important reason for its overseas operation[18]. In fact, there is an extant belief in the literature that retailers' desire to extract better terms from the suppliers is an important motivation for retailers to increase market share (Kacker, 1986) because negotiation on terms and conditions between retailers and suppliers depends *inter alia* on purchasing volume and capacity. The empirical results strengthen this belief. In addition, they add, and emphasise, the international element to this argument.

Drawing from the interview results, it is claimed that a food-retailing firm has to have presence in as many countries as possible in order to obtain better prices when negotiating with multinational suppliers. The Chief Operating Officer of Company F pointed out that multinational suppliers look at all overseas subsidiaries of a multinational retailer as more or less a unit. If a retailer is the biggest in terms of scale in each country where the multinational supplier is present, the retailer will have a very strong bargaining power. At the moment, Company F is among the top three companies in terms of total sales in the commercial field in the world. Approximately one third of its total sales are from operations outside its country of origin. They claimed that with their global scale, they obtain support from the multinational suppliers in terms of guarantee of both reliable supply and good prices in each country they go into. The same claim was also made by the General Manager of Company I, which is of a European origin:

> "When we decided to come into China but before we started our operation, we began to communicate with our existing multinational suppliers who have operations in China. Because of our scale world-wide and our existing relationship with them, it took very little effort on our part to get them to guarantee supplies and provide services to our China operations at prices we are happy with."

The above cases also demonstrate that economy of scale is not the only concern when bargaining power is pursued. There is no doubt that pressure on prices and hence on costs is very strong (Tordjman and Dionisio, 1991 and Pellegrini, 1991, 1994). However, the power of retailers over suppliers on qualitative aspects such as product

[18] These empirical results are presented in section 5.1.2.

quality, guarantee of reliable supply and production specification is also of considerable importance. It is evident that retailers sometimes place huge logistical demands to suppliers in terms of labelling and dates of delivery. Suppliers risk incurring monetary penalties if they violate these 'rules' (Keh and Park, 1998).

A power struggle between retailers and suppliers has always been an important area that draws tremendous research attention within the marketing discipline. The 1980s and 1990s saw increased economic pressures and intensification of competition. There are arguments that collaborative buyer-supplier relationships are one way to cope with the problem and hence there emerged a large amount of literature on long term buyer-seller relationships. It is also witnessed that buyers and suppliers have started examining their relationships with one another and shifting from 'adversarial' transaction relationships to some forms of 'obligational contracting' based on partnership and closer working relationships (Lamming, 1989; Womack *et al.*, 1990; Sako, 1992). The importance of prices, on which traditional competition for contracts is based, is added to by an emphasis on quality criteria such as extension of technical, personnel and managerial assistance by manufacturers (Rubery *et al.*, 1987). Despite such evidence, however, some scholars remain sceptical about the actual extent and nature to which buyer-supplier relationships have truly been transformed. Turnbull (1991 in Bresnen, 1996) and Wilson and Gorb (1983 in Bresnen, 1996) claim that the development of collaborative relationships is often undertaken in an ad hoc manner, driven mostly by narrow and pragmatic concerns to rationalise supply bases and reduced costs associated with transactions and stockholding. Rainnie (1991) goes even further to claim that the notion of true partnership is misleading because his research suggests that terms and conditions formulated under the 'collaborative' relationship are, in most cases, still imposed by the more powerful buyers on dependent suppliers. Consequently, buyers obtain greater efficiency, improve quality and reduced costs through passing the costs and risks to their suppliers. Furthermore, it is apparent that price and cost remain central to managerial decision-making even though there is increasing emphasis on criteria other than contract price. Rainnie (1991) also finds that there is increased dependency for smaller suppliers on a few major clients and as a result, these smaller suppliers suffer from negotiated price reductions and pressure to adopt buyers' costly and interventionist control and quality assurance systems. The dependency for suppliers on buyers is further observed by Chatterjee, Hyvonen and Anderson (1995) during their study with food distributors. They find that food distributors prefer to spread and balance their purchases across a number of suppliers in order to gain awareness of current prices, supply market conditions and product offering, retain the ability to switch suppliers should the need arise and reduce exposure to suppliers' problems such as stockouts. Food distributors believe that these advantages outweigh the disadvantages of increased complexity of the inventory system and reduced average order sizes, and hence reduced quantity discounts as a result of having more suppliers. All this evidence points to the fact that the contemporary emphasis on collaborative or so-called 'win-win' relationships between buyers and suppliers are simply camouflage for attempts to extend and exert greater managerial control over suppliers. The terms and conditions of buyer-supplier relationships is actually a reflection of the power imbalance between them. The reality of control and market power that underpins demand-supply relationships will be revealed when 'partnerships' between buyers and suppliers are deconstructed (Bresnen, 1996).

The arguments presented in the last paragraph demonstrate that no matter how prevalent the concept of long term or collaborating buyer-seller relationship is in the contemporary literature, power and conflicts between channel members are still solidly embedded in buyer-seller interactions. As suggested by the present empirical results, bargaining power over suppliers is what retailers ultimately pursue behind their international expansions.

The cases of companies F and I described earlier also serve as a means to bring the traditional discussion on power struggle in a buyer-seller dyad to the international level, although there is a lack of empirical evidence from the supplier side due to the scope of the present research. To a supplier, having an account with a mass retailer such as Wal-

Mart means doubling or tripling its annual sales (Bolen and Davis, 1997). Because of this, mass retailers are very powerful in asserting influence on their suppliers. Simultaneously, the strong pressure from competition among retailers means that having the lowest possible cost and yet offering merchandise with good quality and services is of ultimate importance to survival. As a result, mass retailers are very compelling in pressuring their suppliers' profit margins. It is found that even giant suppliers such as Procter & Gamble, Unilever and Kraft, who have considerable bargaining power, have felt the squeeze from those giant retailers (Bolen and Davis, 1997). Along with the internationalisation of the giant manufacturers is the internationalisation of the giant retailers. This has changed the landscape of the distribution industry. They no longer operate and interact on a national level. As Akehurst and Alexander (1995) put it,

> "The internationalisation of retailing, the pace of which has quickened in recent years, is redefining channel relationships and the economics of distribution on a global scale."

Interactions between manufacturers who have overseas operations and retailers who have cross-border activities in a country is no longer a stand-alone game. Consequently, retailers strive to internationalise to increase their overall size so that they can possess greater bargaining power over their suppliers.

However, it appears that only retailers with certain overall size can enjoy this 'privilege' with their multinational suppliers. Based on the empirical results, it happens that it is mostly the European food retailers who have this 'privilege'. Most Asian food retailers interviewed admitted that their overall purchases from the multinational suppliers are not significant enough to enable them to have a cross-border influence on these suppliers. Therefore, the relatively smaller foreign retailers have to negotiate with the multinational suppliers in China more or less as if they were stand-alone retailers. This finding further reinforces the argument that food retailers have to continuously extend their size and scale internationally in order to obtain greater bargaining power over suppliers so that they would have a stronger base to compete with their counterparts.

It has to be noted that the four retailers who claimed that bargaining power was a strong driving force for their international expansions are identical to those four retailers who advocated the importance of horizontal market power behind their internationalisation. In other words, horizontal market power goes hand in hand with bargaining power in terms of significance as a motive behind internationalisation of food retailers. This leverages support to the Clarke's (2000) argument that the dimensions of vertical competition between the retailer and the manufacturer over the distribution of profits made from selling the products to the consumers and horizontal competition spatially between retailers in the same catchment for sales of the same products are inseparable in the study of retail power and competition.

According to Clarke (2000), the traditional literature understates the role of retailing in the distribution channel. It tends to define retail competition purely in spatial terms instead of exploring the competition in the whole supply chain. Moreover, most economic literature assumes the existence of perfect competition. It ignores the fact that individual retail establishments have a certain degree of monopoly power, even without high retail concentration in the industry, because of their local uniqueness. Each retail store possesses a distinctive image and reputation and consumers do not have perfect information about different retailers because of high consumer search costs. As a result, a major retailer on its own within a certain catchment area does not have any immediate competition. In a similar vein, the situation of having two retailers within a certain catchment area can also be non-competitive because retail firms will only be in perfect competition when they can capture a perceptible share of market at each other's expense (Steiner, 1991 in Clarke, 2000). Therefore, retailers resell manufacturers' products in an imperfectly competitive market in most cases. In order to rectify the deficiency in the existing literature, Steiner (Steiner, 1991 in Clarke, 2000) proposed a "dual-stage" economic model of retailing that recognises the importance of the co-existence of and interaction between competition for share of margins between retailers and suppliers (vertical competition) and the competition among retailers (horizontal competition) and conceptualises how power derived from vertical competition might affect power derived from local horizontal competition.

Regarding vertical competition, Dobson and Waterson (1996 in Clarke, 2000) find evidence of the existence of monopsony power. They claim that

> "...the balance of power has shifted to the extent that retailers can threaten to replace an individual supplier with minimal disruption by being able to draw on its network of existing suppliers or find a new supplier only too willing to step in" (Dobson andWaterson, 1996:32 in Clarke, 2000).

Clarke (2000) asserts that this supply-based power reinforces power derived from the degree of retail competition in the local market. Power derived vertically through retail concentration is used by retailers to ensure their competitiveness against other retailers in a certain catchment area. When there is no perfect competition among retailers in a certain area, retailers can choose between passing the benefits they derive from vertical competition on to the consumer in the form of lower prices or sales promotion, and accumulating excess profits by maintaining high prices. Lamm's (1981 in Clarke, 2000) study illustrates that food prices tend to be higher where local market shares are concentrated in the hands of a small number of retailers.

To summarise the above arguments, co-existence of oligopsonistic and oligopolistic positions of retailers will give rise to high profits. Retailers are hence driven towards these two positions, and as evident from the present research, this is the main force that drives retailers to expand continuously internationally.

5.1.4 Brief Conclusion on Motivation Behind Retail FDI

The main argument of this section is that internationalisation of retailing is mainly driven by the need and desire of retailers to grow in size for survival given the strong pressure they face from mergers and acquisitions. They also strive to grow in size in order to gain more bargaining power over their suppliers, especially when they are now increasingly embedded in the globalisation of distribution channels. Push factors are believed to be of less importance than some literature suggests. Food retailers are rather proactive in searching for opportunities to extend their market power. The concept of market power is the main thrust that forms the foundation of a comprehensive understanding of the contemporary internationalisation behaviour of food retailers.

5.2 Reasons for Expanding into China

5.2.1 The Empirical Results

During the in-depth interviews, top executives of the foreign side of the food retail joint ventures in China were asked to account for the expansion of their operation into China. Due to the fact that this was intended to be an open-ended question, interviewees were encouraged to elaborate as much as possible. One of the 13 retailers being studied did not offer any comments on the question because the interviewees of this company claimed that they were not in a position to talk about it. Therefore, there were only 12 retailers available for the analysis of this issue.

Regarding the question why the 12 food retailers expanded into China, the results are as follows. All the four European retailers, two of the three Hong Kong retailers, one of the three Japanese retailers and the American retailer, which make up a total of eight, claimed that they were attracted by the 1.2 billion population base, which is one-fifth of the world's population, and the recent economic development of China. They realised that China was a developing country with a transitional economy. However, they saw that huge potential exists in the Chinese market and were impressed with its rate of economic advancement. They expressed strong faith that China will become an important market in the world in the future.

Three out of the eight retailers mentioned in the last paragraph disclosed that sourcing was their secondary reason for having foreign direct investment in China. One of them is from Europe, one from Hong Kong and the other from Japan. The European retailer claimed that they sourced from China 800 million Deutsche Mark annually. The

Japanese retailer also stated that China is a big and important exporter to their business in Japan. Because of this sourcing phenomenon, it is proposed that an underlying element behind these retailers' expansion into China is the possibility of transfer pricing as well as the opportunities to find quality Chinese manufacturers. The Hong Kong retailer did not mention that they source heavily from China but they said that they hoped to develop some kind of relationships with some quality manufacturers in China and source from them for their Hong Kong operation in the future. Nevertheless, they also warned that multinational suppliers in Hong Kong, such as Coca-Cola, might not allow them to source from their corresponding counterparts in China. They believed that the situation would depend on the development of the industry in the future.

In contrast to the rational reason mentioned in the last two paragraphs, sentimental attachment between the founder of the company and China constituted the most important reason for three retailers entering China. The three of them have the origins of Hong Kong, Japan and Taiwan respectively. Their founders always have the desire to contribute to the modernisation of China's retail and distribution industry. For the Hong Kong retailer, who, as mentioned before, does not have operations outside Hong Kong and China, it was seen as a natural growth process to go into China when it perceived that the Hong Kong market had become highly saturated. On the other hand, another Japanese retailer claimed that its immediate reason for going into China was because it was approached by the Chinese government. For all these four retailers, the huge potential of the China market was only one factor that they considered in deciding the timing of expanding into China.

5.2.2 Economic Development and Market Size

As shown in the empirical results, the rate of recent economic development and the market size in China are the major factors that attracted foreign food retailers into China. The economic development of China since the implementation of the open door policy is discussed in section 1.3. Therefore, this is not repeated here.

5.2.3 Market Potential and Retailing Space

All the interviewees mentioned that they saw tremendous market potential and retailing space in China as a result of its economic development and market size. Retailing space is what retailers are always competing for. According to the Chief Executive Officer of Company F, it would take 20 to 30 years for competition as intense as that in Europe nowadays to develop in China. There was a long history of retail development in Europe. The industry was fully mature and there were more than enough players in the market to make the competition very intense. The catchment area of one retail outlet overlapped with that of another in a lot of locations. In order to sustain growth in profit, a retailer had to continuously look for "space". China happened to be a relatively untapped market where modern food retailing started only about six years ago. The modern food retailing industry was still in its early developing stage. There were still plenty of places where a food retailer could open an outlet with a relatively large catchment that should ensure a promising business. Therefore, he believed that China was a very "spacious area" for veteran European food retailers such as themselves to expand and establish a strong position before other players emerge, even though he was aware of the negative factors that existed at the moment[19]. He further perceived that China would become a very important market in the world in the future because one-fifth of the world's population resides there. Because of this perception, he considered that their company's position in China would affect their overall position in the world. Consequently, China had become one of the strategic locations of Company F.

The case above brings out an important issue: retailing space, which in turn can be discussed in terms of learning and first mover advantages.

Retailing Space

Quantitatively, in terms of geographical coverage of the existing food retail outlets in China, China is a very 'spacious' country in which foreign food retailers can develop.

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[19] These negative factors include inadequate phone networks, railways, electric power and water supplies that severely impede a wide range of commercial activities.

Table 5.1 shows the number of supermarket and hypermarket in a number of European countries and in Shanghai. Only a small number of countries are shown because the purpose is to present a rough idea on how much 'retail space' China has, in quantitative terms, in comparison to some other countries. The table does not aim to measure the geographical coverage of the existing grocery retailers in each country in a precise manner. In addition, obtaining reliable statistics on store outlets in China is very difficult. Therefore, Shanghai, one of the most progressive Chinese cities in terms of commercial development, is used as a reference in the comparison. In the table, the number of supermarkets per 1 million inhabitants and the number of hypermarkets per 1 million inhabitants are calculated. These two numbers in Shanghai are apparently lower than that in other countries in the table. Consequently, Shanghai appears to be much more 'spacious' than many other countries. Furthermore, as Shanghai is the Chinese city in which retail development is the most advanced, other places in China should be even more 'spacious'.

Qualitatively, China also offers much room for retailers to bring in and modify their 'innovation' and to build up customer awareness and loyalty. This feature makes China very attractive to foreign retailers because it is unique to China. As an emerging market, there is only a small number of affluent people in China at the moment who have the financial means to afford comparatively expensive products and services, and have the education and consumption experience that allow them to be aware of and desire foreign life styles and foreign retailers. However, it is the dualism of a large group of less well-off people alongside this small group of wealthier people that generates opportunities for foreign retailers. While foreign retailers are anticipating the full blossoming of the market, they are able to sell their goods readily to the affluent segments[20] (Hill and Still, 1984 in Nakata and Sivakumar, 1997), accumulate more knowledge on the China market and hence adjust themselves to adapt more to the market.

[20] The affluent segments in China are mostly located in the more developed areas such as Beijing and Shanghai, and other coastal cities.

Table 5.1 Population/Number of Grocery Outlets Ratio of Selected Countries in 2000

Country/ City	No. of Supermarkets * [2]	No. of Hypermarkets * [3]	Population (million) (Approx.) **	No. of Supermarkets per 1 million Population	No. of Hypermarkets per 1 million Population
France	6041	1105	59	102.4	18.7
Germany	17787	1544	82	216.9	18.8
Spain	4313	306	39	110.6	7.8
UK	5610	1109	59	95.1	18.8
Hungary	664	24	10	66.4	2.4
Shanghai[1]	Approx. 1200[#]	Approx. 50[#]	15[##]	80	3.3

Sources:
* IGD. 2001. *European Grocery Retailing 2001*. Watford: IGD Business Publication.
** World Bank. 2000. *Entering 21st Century: World Development Report 1999/2000*. New York: Oxford University Press.
[#] Moustakerski, P. 2001. *GAIN Report: China, Peoples Republic of, Retail Food Sector Report 2001*. Shanghai: US Agricultural Trade Office. [Online] Available from: URL: http://www.atoshanghai.org/news.htm [Accessed 22nd February 2002].
[##] China Population Information and Research Centre. 2002. *Total Population of China by Region Year-End 1998*. [Online] Available from: URL: http://www.cpirc.org.cn/region.htm [Accessed 22nd February 2002].

Note:
[1] The US Agricultural Trade Office (ATO) Shanghai claims there is no unified official government source of retail census data in China and therefore producing reliable statistics on store outlets and sales is difficult. The number of supermarket and hypermarket outlets shown in this table are approximation estimated by the US ATO Shanghai Office of a major city in China such as Shanghai, Beijing or Guangzhou.
[2] Store size between 400 and 2500 sq. meter
[3] Store size over 2500 sq. meter

5.2.3.1 Learning

The point on accumulating knowledge and adapting is of paramount importance. It is found that early entrants in China are confronted with greater operational risks than late movers in the start-up phase of international expansion (Luo, 1988). Because of the uncertainty regarding the ultimate dimensions of the market, the efforts of rivals to pre-empt that market, the specifications of the inputs needed for production and the specifications of the products likely to be most successful in the future, nature of product design at this stage is unstandardised in order that further improvement could be made (Vernon, 1966). This implies that a substantial amount of learning is involved at the start-up phase of foreign direct investment of a firm. In the context of foreign food retailing in China, the style and formats introduced by the foreign retailers through their foreign direct investment is equivalent to the new product in Vernon's term. Owing to the transitional nature of the China market, and that the retailing sector has been closed from foreign direct investment until less than a decade ago, there exists high uncertainty about the market situation, the techniques of foreign operation, business culture, consumers' taste, government policy and a lot of other environmental constraints. Such information and understanding cannot be easily or rapidly acquired. It can only be developed through actual experience of foreign operations (Johanson and Vahlne in Welch and Luostarinen, 1988). Consequently, the contemporary stage of foreign direct investment of food retailers in China is an experimental and learning phase. This point on learning is best illustrated by the following remark from the Chief Food Purchasing Officer of Company F,

> "(Our foreign direct investment) has got to do with...know-how power, because whenever you need to grow, you need to learn and the new system of the next century will come out of Asia, not from Europe, not from America...Whenever you build yourself in a new market, you need to learn and will learn something. The future markets in which one can build oneself are in Asia. So, retailers from Europe and America have to come here and learn from Asia. We are just like power plants. We have to go on building and building and learning and learning. If we don't come here to learn at an early stage, the markets will develop in some ways we don't understand and then it will be very difficult for us to invest in these newly emerging markets in a later stage."

In general, the longer a foreign firm operates in the host country, the more capability it tends to develop (Chang, 1995; Makino and Delios, 1996 in Luo and Peng 1999). As a result, the foreign food retailers who are in China now would acquire a significant competitive advantage compared to those food retailers who would enter China later[21]. It is this desire of knowledge acquisition that drives the international expansion of most of the interviewed foreign food retailers into China.

5.2.3.2 First Mover Advantage

On the other hand, emerging markets are generally characterised by goods and services of low quality. In such an environment, first movers will be capable of pre-emptively occupying the 'quality space' and hence achieving sizeable sales, provided their products are within the financial and physical reach of consumers. Foreign retailers can benefit from this situation especially, because many consumers in developing countries automatically associate superior quality with foreign retailers, thus creating a positive halo to stimulate trial (Nakata and Sivakumar, 1997). Therefore, pioneers who offer high quality products and consistently meet buyer expectations can consolidate loyalty (Nakata and Sivakumar, 1997). This situation is also found in China. The opening and modernisation of the retailing sector in China was started about seven or eight years ago. In contrast to their counterparts in the more developed countries, the consumers in China possess less information and purchasing experience. They are still trying to catch up with the proliferation of brand names available in the market. It appears to them that there is a forever-growing spectrum of foreign goods to choose. They are attempting to bridge the 'experience gap' in respect of brand names and retailer names. At the same time, resembling most consumers in other developing countries, the Chinese consumers prefer imported goods or goods with a foreign brand to local goods. Foreign products are psychologically considered to be of higher quality and possess better functioning, features and style. They are also perceived as a symbol of status and modernity (Mun, 1988). In the case of fast moving consumer goods, shopping at supermarkets and

[21] A more detailed discussion on learning and organisational capability as a source of competitive advantage will be given in the chapter on competitive advantages.

hypermarkets, especially the foreign-owned ones, becomes a modern trend. The comment of the Chief Operating Officer of Company F supported this view,

> "...everybody wants to shop in our stores, regardless of what format we are. They know that we are famous internationally and so they want to shop here..."

As a result of the lack of a solid history about consumption, Chinese consumers are learning and are susceptible to ideas and influences. This provides foreign food retailers a good opportunity to shape the industry in China, to 'educate' the Chinese consumers and to build up their image among them[22].

When the quantitative and qualitative aspects of retailing space being offered in China are considered together, China could be regarded as a country that provides much space for foreign food retailers to experiment and learn how to operate without much threat of competition.

5.2.4 (Potential of) Sourcing from China

Sourcing is an important activity to retail operation because retailing involves offering consumers an assortment of products created from a variety of sources. Purchase price is one of the several criteria retailers used to evaluate whether or not to buy a product from a certain supplier. The retailing industry in many developed countries is undergoing the processes of concentration and intense competition simultaneously (Liu and McGoldrick, 1995). As a result, retailers have to pursue alternative profit-enhancing strategies other than raising retail prices. Sourcing from countries such as China where products are offered in much lower prices resulting from substantially lower costs of production is one of such strategies (Liu and McGoldrick, 1995).

According to the Chief Operating Officer of Company F, Company F exported substantially from China. At the time of interview, the products they sourced from China

[22] There are certainly first mover disadvantages, such as lack of competent human resources, complicated and confusing legal and regulatory infrastructure and immature logistics system. These issues are seen as complexities of FDI for retailers and they are discussed in Chapter 6 and Chapter 7.

amounted to 800 million Deutsche Mark. Similarly, the General Manager of Good Goods Division of Company L said that their home business imported considerably from China too. Furthermore, he claimed that setting up their own retail operations in China facilitated the search for suitable suppliers in China for their domestic operations. The China Development Director of Company A shared a similar opinion,

> "As our operation in China develops, we hope that we would develop some kind of relationships with the manufacturers here in China. Our next step then would be to source products from them for our domestic operation. This was one issue we considered at the time when we contemplated undertaking foreign direct investment in China. This is not something that we can achieve in a short time but it is the direction we are gradually moving towards. We believe that ultimately there should be a very high chance of doing it. Having said that though, whether we will really do it depends on the development. For example, at the time being, I would imagine that the domestic manufacturers we used to deal with, such as Coca Cola Hong Kong, may not accept such behaviour and hence would not allow, say Guangzhou Coca-Cola, to ship products to Hong Kong. However, whether it is possible will depend on how they develop in the future too."

These three illustrations do not only reconfirm that China is an important exporter to international retailers but also suggest that Drucker's (1985 in Dawson, 1993) opinion on internationalisation of sourcing could be a renascent tenet for retail internationalisation into developing countries in the 1990s and 2000s. On the contrary to having a domestic retailer becoming more international by extending its sourcing to new countries, Drucker regards Sears, Roebuck's activity in Mexico as a process in which a retailer establishes a branch outlet in a foreign country and stimulates local producers to make products of specifications of higher quality by encouraging local sourcing for the branch outlet. Dawson (1993) claims that this type of internationalisation appears to be less appropriate for the 1990s than it did for the 1950s because retailers in contemporary era have higher possibility of becoming involved in the production process of foreign-based manufacturers without having to establish stores in the country. However, the cases of Company A, F and L just mentioned reveal that the internationalisation process suggested by Drucker in the 1950s is still pertinent to the food retail internationalisation in the present case of China, which is an emerging market. Based on the discussion with the three persons in those three companies, China as a low-cost producer is an attractive source of products for the international food retailers. Nevertheless, it is still a developing country and hence quality varies greatly from manufacturer to manufacturer. It involves a considerable amount of searching before a foreign food retailer could decide who are the suitable supply candidates. Moreover, there exists a gap between the requirement of foreign food retailers and the quality standard of most local manufacturers. Time and effort are needed for foreign food retailers to educate the local manufacturers to close the gap. It is difficult to achieve from a long distance. Setting up foreign operations in China and sourcing locally would help foreign food retailers to understand the local manufacturing market and simultaneously simulate local manufacturers to produce products of high quality required by the foreign food retailers for both their local and international operations. Furthermore, undertaking foreign operations in China facilitates the establishment of relationship between foreign food retailers and local producers through their close encounters. It has to be noted that the sourcing purpose is not the primary motive for foreign food retailers to enter China, as mentioned in the empirical work result section, but this rationale is the second most important reason expressed by three retailers out of the twelve interviewed in explaining why they chose China.

5.2.4.1 Global Spatial Strategy

Apart from discussing sourcing from China as a stand-alone issue as in the above, on another level, it could also be considered within the global supply network of an international food retailer. In an earlier discussion on growth and market power, it is concluded that food retailers have to grow to increase their market power. Strategic addition of new stores could be one means to achieve growth and it is termed spatial strategies by Mercurio (1984 in Cliquet, 1998). There exist different spatial strategies in the retailing literature. Ghosh and McLafferty (1987 in Cliquet, 1998) suggest three location strategies that lead to growth:

- Increase market coverage by opening new outlets in new market areas with existing merchandise;

- Expand the network of outlets in existing market areas;
- Simultaneous geographical expansion and store diversification with new merchandise and outlets in new market areas.

Davidson *et al.* (1988 in Cliquet, 1998) also offer a similar location strategy:

- Market expansion by opening new outlets close to existing ones, setting new outlets in a new market area that is at some distance from the existing market area, and acquisition.

Cliquet (1998) asserts that 'spatial strategies' such as these in the prevailing retail literature concern only single store location. He believes that single store location is important but an appropriate spatial strategy should also concern the network performance of all the outlets of a retailer. Because of intense retail competition, the best location of an outlet is one of the most critical criteria of network performance. This location criterion deals not only with single store location but also with global network location. In other words, the real issue is to develop a strategy that would enable the retailer to cover a sufficient territory in order to increase visibility vis-à-vis customers and vis-à-vis suppliers. By reinforcing retail networks, a retailer could increase its economic power over its customers, the end-users, and its suppliers.

The belief of the Chief Executive Officer of Company F that their company's position in China would affect their overall position in the world is an illustration of Cliquet's (1998) tenet that each store location should be considered in terms of the retailer's global network. The Chief Operating Officer of this company also commented that,

> "You buy from international companies. They have group prices. You negotiate with bigger suppliers [in China] using the European prices. If you are number one in each country, you will have bigger power on this."

Globalisation in the manufacturing sector has become prominent before that in the retailing sector did. As discussed in a previous section, a multinational retailer will possess stronger bargaining power over multinational manufacturers if it occupies a strong market position in most of the countries that the multinational manufacturers perceive as important geographical source of profit and in which the multinational manufacturers are present. In a similar vein, multinational retailers could exploit its strong position in the global scale when negotiating with local manufacturers terms of supply for their operations both within and outside their host countries. In the case of China, a number of multinational manufacturers, such as Procter & Gamble, Coca-Cola and Nestlè, entered China more than a decade ago. On the other hand, Chinese exports, as pointed out earlier, are an attractive source of supply for the operations of multinational retailers outside China due to low production cost in China. When these two factors combine with their confidence in China's future economic development, China has become one of the important strategic locations among Company F's spatial network if Company F desires to create sufficient global spatial coverage in order to increase visibility vis-à-vis manufacturers.

5.2.5 Brief Conclusion on Reasons for Foreign Food Retailers to Expand into China

According to the above discussion, it is strongly believed that pre-empting competitors from obtaining a big market share and exploiting the 'retailing space' that exists in China at present to learn about the market and experiment their retail formula are two very important underlying reasons for international moves of foreign food retailers into China in the late 1990s and the early 2000s. These rationales are in turn embedded in the confidence of foreign food retailers in the future of China market, based on its current economic development. On the other hand, sourcing from China for their international operations is another significant factor that some international food retailers considered when deciding to undertake foreign direct investment in China.

Apart from these two rational motives, sentimental attachment to China is also regarded as an important reason for a few food retailers for choosing China as their target of foreign direct investment.

5.3 Internationalisation Process

As mentioned in Chapter 2, the behavioural approach to FDI treats internationalisation of a firm as a process in which the enterprise gradually increases its international involvement. One main theoretical line using this approach is the Uppsala International Model by Johanson and Vahlne (1977). The theory argues that such a process evolves in an interplay between the development of knowledge about foreign markets through local operations on one hand, and an increasing commitment of resources to foreign markets as time goes by on the other. The growth of multinational firms, especially in a volatile environment, is perceived as a sequence of investments where each investment feeds back information that can be used to improve the quality of subsequent investment decisions. It is believed that market knowledge affects decisions regarding commitment of resources to foreign markets and the way current foreign direct investment activities are to be performed. Simultaneously, current foreign direct investment activities and commitment decisions will affect market knowledge and market commitment. Consequently, this process forms causal cycles.

More detailed discussion on the process model, including the importance of market knowledge and commitment, is given in section 2.1.2.1. Two patterns of internationalisation that associate with the process model are mentioned in Chapter 2. One pattern is that a firms' commitment of resources to foreign markets increases as they go along the internationalisation process, which usually starts off with irregular exports and ends up with establishing and managing their own manufacturing plants in the foreign countries. The other pattern is that firms enter new markets with increasing psychic distance. In the context of internationalisation process in the retailing industry, the first pattern is not of much relevance because as pointed out in Chapter 2, retail services are non-tradable. Therefore, this section is devoted to evaluate the validity of the psychic distance thesis in the light of the case study materials obtained from the author's fieldwork. In fact, the present study finds that the concept of psychic distance is ambiguous and the internationalisation process of many retailers do not seem to follow a clear pattern.

5.3.1 Psychic Distance Concept

Johanson and Vahlne (1977), Johanson and Wiedersheim-Paul (1975) and Hornell, Vahlne and Wiedersheim-Paul (1973 in O'Grady and Lane, 1995), who carried out research on Nordic multinationals, were recognised as the advocates of the concept of psychic distance. This concept is the foundation of their internationalisation process model. They distinguish two different kinds of information. The first kind is the market knowledge that comes from direct experience in the foreign market and an understanding of its internal relationships. The second kind is the more objective, factual, general market information that is easily transmitted and learned without the need for experience in interpretation. The former, instead of the latter, is what firms need when establishing international operations. Furthermore, the Swedish researchers claim that psychic distance is an important variable in understanding the dynamics of the internationalisation process. Johanson and Vahlne (1977, 1990) argued that firms tend to commence the internationalisation process in countries that are psychically close to their country of origin before investing in the psychically more distant countries. Their logic for this argument is that entering countries that are psychically close reduces the level of uncertainty that firms would face in a new market (Johanson and Vahlne, 1977, 1990) and that such countries are easier for firms to learn about (Kogut and Singh, 1988).

Definition of Psychic Distance

Psychic distance can be understood as the degree of uncertainty about operations in foreign markets (Whitehead, 1992). Initially, Nordstrom and Vahlne (1992) define psychic distance as "factors preventing or disturbing the flow of information between potential or actual suppliers and customers". As further studies on internationalisation process using the concept of psychic distance developed, varied definitions of psychic distance were derived, depending on the way in which the concept is operationalised. According to Vahlne and Wiedersheim-Paul (1973 in Nordstrom and Vahlne, 1992), psychic distance was understood and measured by the following variables between the domestic and the host countries: level of economic development, level of education, business language, culture and local language, and existence of previous trading channels. Vahlne and Wiedersheim-Paul obtained information about those variables of the domestic and host countries from publicly available statistics and data from the Swedish Export Board. Later studies by Kogut and Singh (1988) and Benito and Gripsrud (1992) borrowed Hofstede's (1980) research and measures of culture to quantify the cultural distance between different countries. In other words, they used cultural distance as a synonym and proxy for psychic distance. This usage was then challenged by Nordstrom and Vahlne (1992). Both agreed that cultural distance and psychic distance captured overlapping phenomena, but they point out that the two attributes do not embrace the same set of elements. In addition to the cultural dimensions as defined by Hofstede, psychic distance is also comprised of structural dimensions (such as legal and administrative systems), language differences and other business difficulties such as industry structure and the competitive environment (O'Grady and Lane, 1995).

The present study does not argue what psychic distance should be and how different it is from cultural distance. Therefore, for the purpose of section 5.3, psychic distance is defined in a more general sense and comprises the economic, political, legal, geographic and cultural distance as well as language differences.

5.3.2 Past Studies Supporting the Internationalisation Process Model

The destinations of international expansion of retail firms demonstrate many of the characteristics expected from the literature on psychic distance. Initial movement into geographically or psychologically close countries is widely recognised as a feature of the early stage of internationalisation. The study of Treadgold and Davies (1988) found high proportion of French investment destined for Spain and Italy, German investment for Austria and British investment into Ireland. This dominance of intra-European investment reflects a high degree of 'border-hopping' activities and hence provides supporting evidence to the argument that initial internationalisation activities take place in the geographically or psychologically close countries. Dionosio and Tordjman (1991 in Dupuis and Prime, 1996) insist on the cultural proximity of the target foreign market. Simultaneously, there are also examples from certain studies that conform to the tenet that less culturally and psychologically close countries are entered as time has progressed and internationalisation experience of a multinational firm has grown. Those examples include the moves of the French retailers into South America, the German and Austrian moves into Eastern Europe (Burt, 1991), and the moves of Carrefour and Safeway into the Far East and Latin America during the second half of the 1980s.

5.3.3 Evidence in the Literature against the Internationalisation Process Model

Whitehead (1992) argues that if the psychic distance pattern is to be followed, British retailers could be expected to expand into Northern Europe and Southern Ireland, Australian retailers into New Zealand and Japanese retailers into Taiwan and Singapore. However, he found that historical evidence of British retail expansion suggests a different pattern. Instead of entering into their neighbour markets in Europe, they turned their attention to North America. Examples include Marks and Spencer and Sainsbury's. Whitehead attributes this deviation from expectation to the fact that either internationalisation process is industry-specific, or that the first step of internationalisation for British retailers has been ad hoc and opportunistic.

Similar counter evidence is found in the work of Hedlund and Kverneland (1985 in Johanson and Vahlne, 1990). In their study of Swedish firms in Japan, it is found that the development patterns of those firms were inconsistent with those expected on the basis of the internationalisation process model. The explanation they claim for such a deviance is that there has been a general internationalisation of industries and markets. Consequently, the lack of market knowledge no longer affects the pace and patterns of internationalisation of firms.

Nordstrom (1990 in Johanson and Vahlne, 1990) went further to argue that the world has become more homogeneous and it leads to the fading of psychic distance. Subsequently, Britain, Germany and the United States have become common targets for the initial foreign entry of many Swedish firms. Other environmental changes also play a part in shaping the internationalisation process. Examples of environmental changes that have an impact on the internationalisation process include improved information supply, more efficient means of information transmission, less fragmented markets, and increased emphasis on R&D .

In addition to the above counter arguments, Millington and Bayliss (1990) discovered from their research that ad hoc international growth usually characterises the early internationalisation process of a firm. Ad hoc growth is only superseded by formalised planning and systematic search when a firm's experiential knowledge about foreign markets increases. Cavusgil (1980) proposes two distinct modes of international expansion. One is a formal structured planning mode where search for new markets is deliberate and planned. The other is a disjointed adaptive mode where foreign investment decisions are made on a more random "piecemeal step-by-step basis". Due to these different perspectives towards the internationalisation process, Whitehead (1992) questions whether evidence from the distributive sector supports the process model of Johanson and Vahlne (1977) and whether the nature of the decision making process in the internationalisation of retail activity is disjointed or planned. Furthermore, he also points out that one weakness of the psychic distance process model does not take retrenchment of foreign investment, which happens frequently, into consideration.

5.3.4 Cultural Distance

Regardless of whether internationalisation process of retail firms follows a certain pattern or not, cultural issues remain as a very important aspect to retail internationalisation. This topic is the centre of discussion in a substantial amount of marketing and internationalisation literature. The topic/subject is also an important element in the concept of psychic distance, although it is not the only element.

Nevertheless, the implication of culture for internationalisation is a controversial topic, like the process model of internationalisation that was discussed above.

5.3.4.1 Implication of Culture for Internationalisation basing on the existing literature

A spectrum of opinions exists on the implications of culture for international business. A certain school of thought argues that markets are becoming more homogeneous (Levitt, 1983 in Helfferich, Hinfelaar and Kasper, 1997; Nordstrom, 1990 in Johanson and Vahlne, 1990). New technology has emerged and this increases the ease of movement of people and communication, which in turn facilitates and accelerates globalisation (Appadurai, 1990 and Naisbitt, 1995 in Helfferich, Hinfelaar and Kasper, 1997). Consequently, the differences in cultural preferences, national tastes and standards, and business institutes are diminishing. International firms will produce standardised products worldwide because that is what everyone demands. In particular, there are few cross-cultural differences between white-collar workers, and between groups that consist of people with a high level of income and education (Katona, Strumpel, and Zahn, 1973, Thorelli, Becker and Engledow, 1977 in Martenson, 1988; Martenson, 1988). Martenson (1988) claims that luxury products are the same anywhere in the world. Youth products such as jeans and music are highly international too. Low-price, but good-value, products also sell well in almost any market in the world. IKEA's international success was largely credited to the fact that their target customers in any market in the world were well educated, young[23] and in the early phase of their life cycle with one or no children (Martenson, 1988). Martenson further asserts that less emphasis on family tradition and more emphasis on individual experience, together with an increase in the number of single people in the society, have led to the rapid dissolution of cross-cultural barriers. Therefore, Martenson alleges that cross-cultural differences in values will have diminishing significance in the coming future and similarities instead of differences across borders will become the determinants for global success.

[23] Between 18-40 years of age and are less interested in investing heavily in furniture and hence willing to make the effort to assemble and transport the furniture themselves.

Conversely, there is another school of thought that claims that globalisation is forced on consumers instead of being induced by them. This results in cultural differences being neglected to the detriment of both consumers and international firms. In other words, this school of thought recognises the importance of cultural differences to internationalisation strategies (e.g. Solomon, 1991, Featherstone, 1993 and Steenkamp, 1993 in Helfferich, Hinfelaar and Kasper, 1997; Dawson, 1994b). Alexander (1990) maintains that cultural barriers to retail internationalisation is more profound than technical obstacles. Pellegrini (1992) stresses the impact of cultural determinants of buying and consumption behaviour.

5.3.4.2 Measuring Cultural Proximity

Regardless of which perspective to take on the issue of cultural distance that exists in the international marketplace, one question that must be addressed is how to measure cross-cultural distance so that firms could formulate their internationalisation strategies accordingly. There is no consensus on how cultural closeness should be measured (Vahlne and Wiedersheim-Paul, 1973 in Laulajainen, 1991; Hofstede, 1984; Mole, 1990).

Hofstede's Study

The most well-known research in culture was conducted by Hofstede (1984). He measures national cultures using four dimensions: power distance, uncertainty avoidance, individualism/collectivism and femininity/masculinity. Fifty-three countries were mapped in order to investigate how their responses and attitudes to management and organisation issues varied. In his later study, Hofstede (1991) furnished his framework with one more dimension, named long-term orientation versus short-term orientation, so that more meaningful distinctions between Eastern and Western culture could be attained.

Usunier's and Kasper and Bloemer's Studies

In 1993, Usunier employed Hofstede's data and designed a refined hypothetical map of cultural proximity zones for Western Euorpe (Figure 5.1). These zones are based on an underlying geographic picture and correspond to national cultural groups to a large extent. Kasper and Bloemer (1995) also made use of Hofstede's first four cultural dimensions to analyse data of seventeen European countries by correspondence analysis. A perceptual map of the position of each country relative to the positions of the other sixteen countries and the four dimensions simultaneously was derived (Figure 5.2). From their perceptual map, three clusters of European cultures are found. The first cluster is the Anglo-German cluster that consists of Ireland, Britain, Austria, Switzerland, Germany and Italy. The second one is the Dutch-Scandinavian cluster comprising the Netherlands, Norway, Sweden, Denmark and Finland. The third cluster is the Roman-Southern European cluster that includes Belgium, Spain, France, Greece, Portugal and the former Yugoslavia.

The major difference between Usunier's clustering system and Kasper and Bloemer's perceptual map is the position of some overlap countries, such as the Netherlands and Germany, and the relative positions of neighbouring countries such as the Netherlands and Belgium (Helfferich, Hinfelaar and Kasper, 1997).

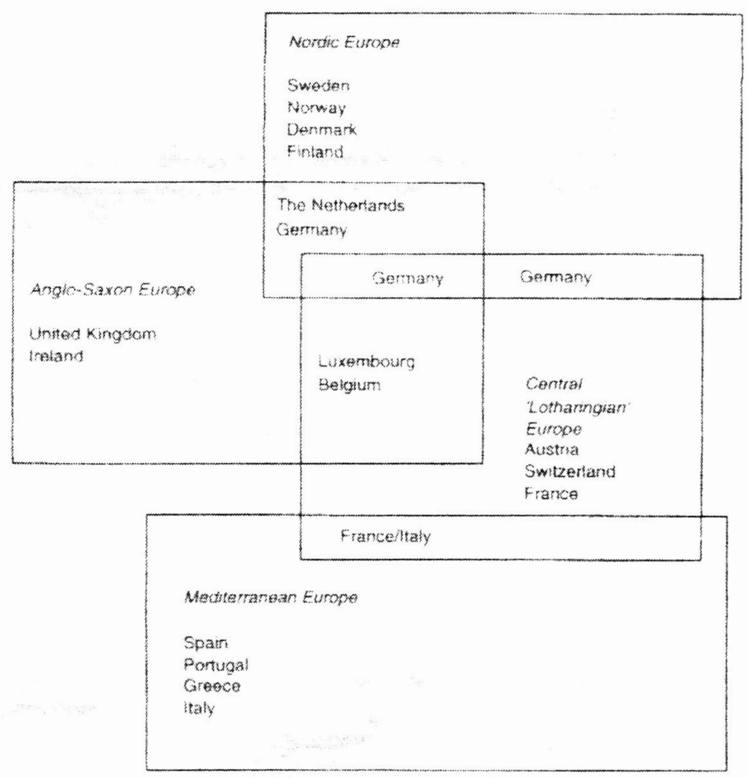

Figure 5.1 Usunier's culture zones of Europe

(Taken from Helfferich, E., M. Hinfelaar and H. Kasper. 1997. "Towards a Clear Terminology on International Retailing". *International Review of Retailing Distribution and Consumer Research.* 7: 287-307.)

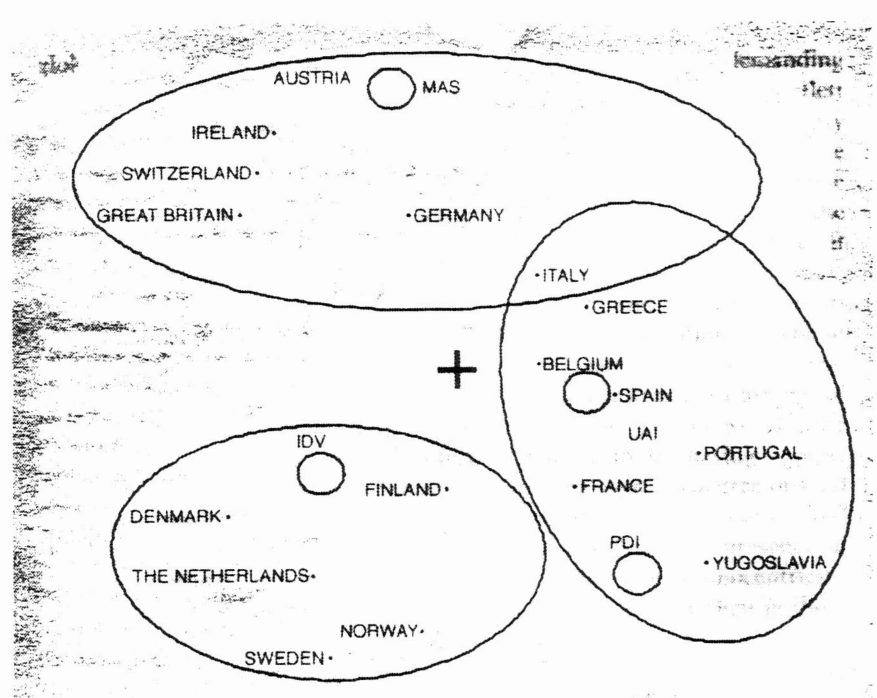

Figure 5.2 Kasper's clusters of European country cultures

(Taken from Helfferich, E., M. Hinfelaar and H. Kasper. 1997. "Towards a Clear Terminology on International Retailing". *International Review of Retailing Distribution and Consumer Research.* 7: 287-307.)

Gatley and Lessen's Study

Conversely, by drawing on the work of Hofstede (1980, 1991), Trompenaars (1993), Hampden-Turner and Trompenaars (1993) and Lessem and Neubauer (1993), Gatley and Lessen (1995) developed a cultural audit system in which there were sixteen cultural variables: time, emotional, hierarchical, relationships, status, profit, systems, ambiguity, rule, control, gender and group[24]. According to their analysis, all the countries in the world could be grouped into four quadrants: the Northern quadrant (Northern Europe), the Eastern quadrant (Asia), the Southern quadrant (Southern Europe) and the Western quadrant (the United States). Within these four quadrants, the cultural distance between the Northern and the Western quadrants and between the Eastern and Southern quadrants are short. This four-quadrant model claims to serve as a useful and practical means for enhancing the awareness and trans-cultural management skills of management personnel, and to act as a tool that helps define cultural issues relevant to the national and trans-national business activities of multinational companies.

5.3.4.3 Validity of the above Cultural Clustering Models

There is evidence suggesting that the cultural zones established by Usunier (1993) and Kasper and Bloemer (1995) could be of relevance to a certain degree to retailers' choices on foreign markets and formulation of marketing strategy. For example, a few years after the Dutch retailer Ahold had established its drugstore Etos in Begium, differences in consumer expectations and buying behaviour were found to be so great that Ahold had to withdraw from the market. Koninklijke Bijenkorf Beheer also had to make a drastic change to the format of their Dutch variety store, Hema. However, a lot of other Dutch-based formats, such as Halfords, Blokker and Free Record Shop, are successful in Belgium (Helfferich, Hinfelaar and Kasper, 1997). This mixed experience of the border-hopping activities of Dutch retailers is consistent with the discrepancy in the interpretation by Usunier and Kasper and Bloemer of the Hofstede data regarding the relative positions of Belgium and the Netherlands.

Nevertheless, Hotstede's Data and the cultural cluster systems derived from them by Usunier and Kasper and Bloemer have limitations (Helfferich, Hinfelaar and Kasper, 1997). They are based on national boundaries, which become artificial when the question is about cultural proximity. This point is made valid by the recent developments in Eastern Europe. The cultural clusters Of Usunier and Kasper and Bloemer cover only the seventeen European countries investigated by Hofstede. There are another thirty-six in Europe that are yet to be analysed.

Despite the above limitation to the cultural cluster models, they will nonetheless be the starting analysis point for the information regarding internationalisation process obtained from the present case studies. The reason for this is because they are the more recognised models in the field of cultural studies against the background discipline of international business.

5.3.5 Analysis of the Internationalisation Processes of the Retailers in the Present Research[25] Basing on the Above Models of Measuring Cultural Proximity

5.3.5.1 European Retailers

According to their sequence of first entry into different countries, different patterns are found. Metro's internationalisation process follows closest to the pattern suggested by the process model. It went into Austria and France, which is, according to Usunier's model, located in the same cultural zone as the one Germany is located, when it first went across the German border. Afterwards, it approached Denmark which is located in the adjacent cultural zone. The next country they went into was Italy, which is located in another adjacent cultural zone to the one in which Germany is located. In 1994, it went further to Central Europe and then to China in 1996 (Table 5.2).

[24] For details of their cultural audit system, please refer to their article.

[25] The information about the history of internationalisation of the retailers mentioned in this section is obtained from their Annual Reports of various years.

Table 5.2 Internationalisation History of Metro

Metro C&C GmbH [1]	
Year of First Entry	Country
1964	Germany
1971	Austria
1971	France
1971	Denmark
1972	Italy
1990	Turkey
1994	Hungary
1996	Romania
1996	China
1999	Bulgaria

Note 1: As internationalisation history is the subject of analysis, Metro is considered separately from SHV Makro in this particular section, despite the merger of Makro NV Cash and Carry and Metro Holding AG (CH) in 1998.

On the other hand, the internationalisation history of Continent and Makro shows that the countries they went into before a certain year are also located in the same or adjacent cultural zone to that in which their countries of origin are located. Nevertheless, the footsteps of those two retailers after that certain year appear to be less consistent with the cultural proximity tenet. For example, all the countries that Continent entered before 1995 were located in the same cultural zone as the one in which France is located. However, the countries it went into after 1995 were scattered in various cultural zones (Table 5.3). A similar phenomenon is also observed with Makro. All the countries Makro entered before 1972 were located in the same cultural zone as the one in which the Netherlands is located. In 1972, it entered Spain, which is located in the next cultural zone. After 1989, however, it approached countries located in various parts of the world, including Asia, Central Europe, Latin America and southern Europe (Table 5.4). These regions, according to Gatley and Lessen's model, are very different in terms of culture.

Table 5.3 Internationalisation History of Continent

Continent (2)	
Year of 1st Entry	Country
1970	France
1976	Spain
1976	Germany (acq) (wd. in 1996)
1985	Portugal
1987	Italy
1991	Greece
1995	Belgium
around 1995	Morocco
around 1995	Mauritius
around 1995	Taiwan
around 1995	Turkey
around 1995	Dubai
around 1995	Argentina

Note 2: As internationalisation history is the subject of analysis, Continent is considered separately from Carrefour in this particular section, despite the merger between Carrefour and Promodès (the retailer that Continent belongs to) in 1999.

*acq = acquisition
wd = withdrew

The internationalisation track of Ahold and Carrefour shows the least conformation to the cultural proximity tenet among all of the European retailers being studied. Ahold N. V. was founded in 1973 in the Netherlands (Table 5.5). When it first went abroad in 1979, it chose the US, which remained an important market for Ahold for the next one and a half decades. It has to be noted though that Ahold's involvement in the US market is entirely in the form of acquisition. The second main overseas market that Ahold went into was Czechoslovakia, a Central and Eastern European country. Ahold saw the fall of communism in Central Europe in 1990 and decided to seize the opportunity and enter this market. Then, its internationalisation effort was directed towards Asia and Latin America albeit investment was also made in some European countries simultaneously. The path of international development of Carrefour was even more divergent. It initially went into Spain, a Southern European country, ten years after it was founded in France (Table 5.6). Two years later, it involved itself in Brazil in Latin America. That was followed by entry into Argentina, another Latin American country. In 1989, it began investing in Asia and started by breaking into Taiwan. The sequence that followed was Southern Europe, Latin America, Asia, Central and Eastern Europe, Asia, Europe (Belgium), Central and Eastern Europe, Latin America, Asia and then Latin America. From the sequence, it could be seen that Carrefour had entered countries with greater cutlural distance (basing on Usunier's, Kasper and Bloemer's and Gatley and Lessen's models) before entering countries with closer cultural distance. Furthermore, Carrefour's internationalisation history does not appear to indicate any sequential path that has a relationship with cultural distance.

Table 5.4 Internationalisation History of Makro

Makro [3]	
Year of First Entry	Country
1968	Netherlands
1970	Belgium
1971	UK
1972	Spain
1989	Thailand
1990	Portugal
1990	Taiwan
1991	Morokko
1992	Greece
1992	Indonesia
1993	Malaysia
1994	Poland
1996	China
1996	Phillipines
1997	Czech Republic

Note 3: As internationalisation history is the subject of analysis, Metro is considered separately from SHV Makro in this particular section, despite the merger of Makro NV Cash and Carry and Metro Holding AG (CH) in 1998.

Table 5.5 Internationalisation History of Ahold N.V.

Ahold	
Year of 1st Entry	Country
1887	established first retail store
1955	1st supermarket in Rotterdam
1973	Ahold N.V. founded
1979	US (acq)
1981	US (acq)
1988	US (acq)
1990	Fall of Communism in CE, Cezchoslovakia
1991	US (acq)
1992	Portugal (jv)
1994	US (acq)
1995	Est. Ahold Asia Pacific in Singapore
1996	US (acq)
1996	Singapore (jv)
1996	Thailand (jv)
1996	Malaysia (jv)
1996	China (SH, Zhongbui Supermarket Co. Ltd) (jv)
1996	Brazil (jv)
1996	Spain (jv)
1996	Poland (jv)
1996	Indonesia (jv)
1997	China (SH, Tops) (wd. In 1999)
1998	Argentina, Chile, Ecuador, Peru, Paraguay (acq)

*acq = acquisition
jv = joint venture
wd = withdrew

5.3.5.2 American Retailer

Wal-Mart was founded in 1962 by an American businessman called Sam Walmart in the US (Table 5.7). Its business domain remained within the US for almost three decades before it ventured abroad in 1991 by entering Mexico, a country located in Latin America. Three years later, it opened stores in Canada. In subsequent years, Wal-Mart expanded into China, Germany and the UK. A description of the cultural distance between the US and the countries in Latin America was not included in Usunier's, Kasper and Bloemer's and Gatley and Lessen's models. However, Latin America was an emerging region in the early 1990s. Furthermore, Canada is perceived to be culturally closer to the US than Latin American countries. In other words, the case of Wal-Mart does not show full support to the cultural proximity tenet. However, there is an important observation in this case. First, Wal-Mart is the world's biggest retailer. However, it became an international retailer much later than its counterparts in Europe . Secondly, Wal-Mart commenced the internationalisation process with countries located close to the US and its international moves into countries further away appear to be very 'cautious' in Treadgold's (1988) terms.

Table 5.6 Internationalisation History of Carrefour

Carrefour [4]	
Year of First Entry	Country
1963	France
1973	Spain
1975	Brazil
1982	Argentina
1989	Taiwan
1991	Greece
1991	Portugal
1993	Turkey
1993	Italy
1994	Mexico
1994	Malaysia
1996	China
1996	Thailand
1996	Korea
1997	Poland
1997	Hong Kong
1997	Singapore
1998	Belgium
1998	Czech R.
1998	Colombia
1998	Chile
1998	Indonesia
2000	Japan
2001	Slovakia
2001	Hungary
2001	Switzerland

Note 4: As internationalisation history is the subject of analysis, Continent is considered separately from Carrefour in this particular section, despite the merger between Carrefour and Promodès (the retailer that Continent belongs to) in 1999.

Table 5.7 Internationalisation History of Wal-Mart

Wal-Mart	
Year of 1st Entry	Country
1962	1st W-M
1983	1st Sam's Club
1988	1st supercentre
1991	1st international--Mexico City
1992	Puerto Rico
1994	Canada (acq)
1995	Argentina
1995	Brazil
1996	China
1998	Germany (acq)
1998	Korea (acq)
1999	UK (acq)

*acq = acquisition

5.3.5.3 Asian Retailers

Three patterns of internationalisation process are observed with Asian retailers. First, it is noticed that the internationalisation activities of the two Japanese retailers, Jusco and Seiyu, and a Thai retailer, Lotus, were confined within Asia. Furthermore, Jusco stayed within Japan until the 1980s (Table 5.8) whereas Seiyu only ventured internationally in 1990 (Table 5.9).

Table 5.8 Internationalisation History of Jusco

Jusco	
Year of 1st Entry	Country
1970	Jusco was established
1981	tie with safeway in US
1984	Malaysia Jusco
1985	Hong Kong
1995	Guangdong Jusco in China
1995	Shanghai Jusco in China
Mar 1996	Qingdao Dongtai Jusco in China
(1980s started to promote the business globally)	

Table 5.9 Internationalisation History of Seiyu

Seiyu	
Year of 1st Entry	Country
1963	Seiyu Store, Ltd. was established
1990	Hong Kong
Apr 1995	Singapore
Oct 1995	Indonesia
1996	China BJ
Sept 1996	Thailand BK
Fall 1997	China SH
Contemplating entering in 1997	Vietnam

The second pattern found is that RT-Mart, a Taiwanese retailer, and Park'n Shop, a Hong Kong retailer, had operations in their respective domestic countries and Mainland China only. RT-Mart (Table 5.10) was founded in September 1996. About half a year later, it decided to undertake foreign direct investment in China. The first store in China was opened in July 1998. Its corporate mission is to grow rapidly in Taiwan and China and it anticipates opening more than 100 outlets in China within ten years of entering the market. In the long run, the company also has a strong desire of developing itself into a leading global retailer that would be comparable to those with a European and American origin. On the other hand, Park'n Shop (Table 5.11) is deeply rooted in Mainland China, as mentioned earlier . These two cases demonstrate that the process of engaging in internationalisation activities could be highly linked to sentimental attachment of the decision-maker or of the company history. Sentimental attachment, at the same time, includes the element of cultural proximity. It is logical to argue that when a retailer considers growing overseas, the decision-maker would choose countries from which he comes or with which the company was highly associated in the past. It is because those countries are the countries in which the company possess a relatively high degree of market knowledge in terms of business practice, business culture, buying culture, food culture, lifestyle and the local language. Therefore, the decision-maker believes there is a lower risk in internationalising into those countries. This argument is not well documented in existing literature, because sentimental attachment is always regarded as an irrational reason. However, the two cases here demonstrate that this irrational reason, sentimental attachment, should not be ignored in the context of retail internationalisation, even though these two cases could be special instances.

Table 5.10 Internationalisation History of RT-Mart

RT-Mart International Co. Ltd.	
Year of 1st Entry	Country
Sept. 1996	Founded in Taiwan
Apr 1997	China SH

Table 5.11 Internationalisation History of Hutchison Whampoa Limited, the Parent Company of Park'n Shop

Hutchison Whampoa Limited (HWL)	
Year of 1st Entry	Country
1828	AS Watson in Guangzhou
1841	AS Watson in Hong Kong
1973	Hutchison Properties Ltd acquired Park'n Shop
1977	HWL formed
1984	Park'n Shop in China
1987	acquired Canada's Husky Oil
1989	Telecom in UK and Australia
1991	Park'n Shop opens Asia 1st multi-temp fresh food distribution centre
1996	AS Watson form joint venture with Thai Central Department Store
1999	sold ice-cream business in Shanghai, Guangzhou and Hong Kong to Unilever group
	Park'n Shop also have operation in Taiwan, called Taiwan Watson Park'n Shop Limited

The international moves of Dairy Farm, a Hong Kong retailer, offered the third pattern. The acquisition of the Wellcome grocery chain by Dairy Farm in 1964 in Hong Kong marked the beginning of its serious engagement in the grocery retailing business. Dairy Farm's interest went international in 1979 (Table 5.12) when it acquired the supermarket chain No Frills in Australia. Since then, it has made many international moves. The foreign direct investment activities of Dairy Farm were focused in Asia while its internationalisation activities in the form of acquisition were focused in Europe, Australia and New Zealand were. In its 1998 Group Profile, Dairy Farm announced that they had decided to concentrate on the Asia-Pacific region and would dispose of all of its non-Asia-Pacific businesses. It also declared having the vision of becoming the leading food and drugstore retailer in the region. This case shows that the internationalisation process of Dairy Farm was inclined to have a more ad hoc basis before 1998 and after that year, it has become more focused in the Asian-Pacific region, the cultural quadrant in which Hong Kong is also located, according to Gatley and Lessens' model.

Table 5.12 Internationalisation History of Dairy Farm, the Parent Company of Wellcome

Dairy Farm	
Year of 1st Entry	Country
1964	Wellcome chain stores formed in HK
1979	Acquired No Frills in Australia
1987	Taiwan
1987	UK (acquired Kwik Save) (sold in Mar 98)
1990	New Zealand (acquisition)
1990	Spain (acquisition) (discontinued in Feb 98)
1992	China (7-11)
1993	Singapore
1994	Malaysia
1995	Indonesia (technical assistant agreement)
1995	India (Technical assistant agreement)
1995	China (Wellcome) (joint venture)
1995	Japan (joint venture with Seiyu) (discontinued in Feb 98)

In addition to these three patterns, it is also interesting to note that Lotus and Park'n Shop belong to the bigger conglomerates of CP Group and Hutchison Whampoa Limited respectively. These two conglomerates possess extensive international networks. For example, CP Group has an established network in Asia (including Thailand, Malaysia, Taiwan, Indonesia, Cambodia, India and Vietnam), Europe (including Belgium, Germany and Turkey), the USA, Africa and the Middle East[26]. Hutchison Whampoa Limited has also built its network in the UK, Australia and Canada (Table 5.11). Logically, the two retailers should perceive less psychological distance and encounter

[26] Information Obtained from CP Group's websites.

less difficulty in establishing foreign operations in countries with which their parents have networked, because their parents should possess certain amount of market knowledge of those countries. However, they have not taken this advantage and remain active in a very limited geographical region. This observation suggests that there must exist many factors other than cultural proximity that affect the internationalisation process of a retailer. In the case of conglomerates, one of these factors is the core business direction and strategy of the group.

5.3.6 Implications

The empirical studies of the present research discussed above show that some food retailers progressively entered countries with increasing cultural distance in their internationalisation process. Simultaneously, there is also a significant proportion of the food retailers being studied that did not follow that pattern. In other words, the findings are inconclusive. Therefore, it is inappropriate to argue either for or against the validity of the cultural proximity thesis. Nevertheless, some insights could be drawn from the present case study analysis.

First, one explanation for the divergence from the cultural proximity thesis could be that the internationalisation process of food retailers is not always planned. It could be more situational. Food retailers need to keep growing in order to survive[27]. The political and economic development of different markets in the world keeps changing and it is exogenous to any retailer. Timing of an international move is important. First mover has advantages such as pre-empting competitor's move, building brand loyalty, obtaining market information and experience, and establishing channel relationships. It is an important factor that induces food retail firms to seize the opportunities to expand and grow overseas whenever those opportunities arise[28]. As mentioned above, Ahold explicitly expressed that the fall of communism in central Europe in 1990 opened up the opportunity for them to tap these potentially profitable markets. It entered

[27] This point is discussed in section 5.1.
[28] This point is discussed in section 5.2.3.2.

Czechoslovakia in the same year even though they did not possess much experience in other European markets at that time. Dairy Farm's internationalisation process also appears to be more ad hoc as discussed earlier too. Their moves could be explained by the importance of other factors such as economic and political development, industry infrastructure and intensity of competition in the foreign markets that outweigh the importance of cultural proximity in some food retailers' decision-making process. Furthermore, food culture varies across space (Dawson, 1994b). Many interviewees expressed that they performed thorough market research on what the consumers want before they started their business in any market. Some of the food retailers interviewed further stated that they were always aware of the differences between different markets. This awareness does not only apply to markets in different countries but also to markets in different regions within one country. It is plausible to argue that this recognition of differences in food culture in the food retailing industry diminishes the importance of cultural proximity in the internationalisation process of food retailers.

Secondly, it is believed that some retail formula could be transferred across countries regardless of their cultural distance. IKEA encountered no problem in transferring its standardised formula across borders in Europe. This proved that a standardised retail formula could work across various cultural clusters. Within the food retail industry, one obvious element that retailers transfer across borders is their retail concepts and format. As far as China is concerned, formats such as hypermarkets and cash and carrys appear to be performing well. Nevertheless, it would be imprudent to suggest that food retail formats are universally transferable. It has been witnessed that IKEA began to experience problems when it crossed the Atlantic Ocean (The Economist, 1994 in Helfferich, Hinfelaar and Kasper, 1997). Neither the psychic distance concept nor any of the three cultural cluster models mentioned above could explain this phenomenon. Therefore, more research has to be conducted in order to arrive at a more conclusive understanding on how cultural distance affects the success of transfer of retail formula.

Thirdly, O'Grady and Lane (1995) claim that entering countries with close psychological distance during the initial stage of internationalisation does not necessarily give rise to successful performance in the foreign countries. Their claim is supported by their empirical study with thirty-two Canadian retail companies who have operations in the United States. They found that only seven out of their thirty-two subjects were functioning successfully in the United States. This is due to the assumption of similarity between Canada and the United States that prevents executives from learning about critical differences. Moreover, the 271 CEOs they interviewed confirm that there are greater cultural differences between the two countries than what is assumed. A similar finding is also documented in Simpson and Thorpe's (1997) study. They conducted a case study of an American specialty store operating in Britain. The manager interviewed stressed that the difference between the English culture and the American culture are more significant than what is assumed when it comes to a foreign retail operation. The results of these studies also undermine the importance of cultural proximity in the decision-making process of what countries to enter. Furthermore, they suggest that cultural differences, instead of cultural proximity, should be the critical consideration in the formulation of food retailers' internationalisation strategies.

The studies of O'Grady and Lane (1995) and Simpson and Thorpe (1997) also demonstrated that there is a gap between the perception of decision-makers on cultural distance between two markets and the actual cultural distance. In addition, the actual cultural distance is always found to be greater than anticipated at the beginning. This is another shortcoming of the cultural studies against the background discipline of international business.

5.3.7 Brief Conclusion on the Process Model of Retail Internationalisation

Literature on the concept of psychic distance and cultural proximity is reviewed in this section. Empirical results on internationalisation process of food retailers are analysed. It has been shown that the internationalisation process of only some of the food retailers studied follows a certain pattern Other food retailers appear to be relatively unplanned and on a more ad hoc basis. Similarly, cultural proximity is found to be less critical in the internationalisation process of food retailers. However, it does not imply that culture is not significant to retail internationalisation. Food and consumer culture is very sensitive to geographical space. Cultural difference must be given a considerable amount of attention in the formulation of food retailers' operational strategies in a different market.

Simultaneously, it is believed that factors other than cultural proximity could provide a more plausible explanation to the sequential moves of some food retailers into countries in different parts of the world. Those factors include the economic and political development, industry infrastructure and stage of industry development in a foreign market. As mentioned at the beginning of this section, some scholars call these factors structural dimension and business difficulty and they are treated as elements of psychic distance. According to the definition of psychic distance in this section, the findings of the present research still support the concept of psychic distance. Nevertheless, caution must be made when using the term psychic distance in the discussion of retail internationalisation because different elements in this concept carry different weights in the internationalisation process.

Williams (1992a, 1992b) claims that in order to investigate the internationalisation behaviour of retailers and to avoid confusion, the psychological distance, which is the proximity-similarity perceived by the decision makers between the domestic market and target foreign markets, instead of the actual cultural distance based on the cultural cluster models, or the term psychic distance, should be considered. Dupuis and Prime (1996) extend his idea and propose in their study on internationalisation of a retail format that there are four elements in the psychological distance consideration. The four elements are:

- the consumer (location, equipment, shopping habits);
- the retail store: concept and retailing mix (core business, assortment, localisation, price, communication, human resources management);

- the channel mix: relationship management with both internal channels (retail store, staff, central purchasing) and external channels (suppliers, wholesalers, and other partners);
- the environment: public opinion, and the economic, political, legal, competitive and technological environment).

These elements are of high relevance to the present study and are discussed in the appropriate chapters presented later in this thesis.

Chapter 6 Market Entry

Chapter 6
Market Entry

Since the Communist Party seized power and formed the People's Republic of China in 1949, China's retail and distribution system had remained under-developed for more than four decades. This was because the retail and distribution sector was largely neglected under the communist regime. Commodities were mainly allocated on a ration basis. Consumers were deprived of Western shopping experience. 1979 saw the implementation of the 'open-door' economic policy in China but the retail and distribution sector remained immune to foreign investment for another twelve years. In July 1992, the State Council promulgated the Foreign Investment in Retailing Provisions. The Provisions provides for foreign investment in retail businesses, which was allowed in several locations in the country. Since then a number of multinational retailers have entered the market and they have induced profound changes and advancement in the retail and distribution sector. Nevertheless, this sector has remained highly regulated until recently. After making a number of concessions to the Western world, China became a member of the World Trade Organisation (WTO) in December 2001. Being a member of the World Trade Organisation requires China to gradually relax its policies regarding foreign trade and foreign direct investment. One aspect of such liberalisation is that the current regulation on foreign direct investment in the retail and distribution sector will have to gradually disappear within the next three to four years.

This chapter examines the market entry mechanism of foreign investment in the retail and distribution sector in China. The first section in this chapter reviews the relevant stipulated regulations and investigates the problems with the existing legal and regulatory infrastructure. The next section provides an evaluation of the modes of entry that are allowed to foreign retailers. Issues regarding partner selection are also included in the discussion. The third section scrutinises the site selection and store development processes of foreign food retailers in China. The last section examines the relationship between foreign food retailers and the Chinese government at different levels. The cultural issues that affect foreign business practitioners and the attitude of the Chinese government towards foreign direct investment in the future is also considered in this final section.

6.1 Legal and Regulatory Infrastructure

6.1.1 Stipulated Regulations[1]

6.1.1.1 The 1992 Promulgation

The Chinese government opened its door to foreign investors in retailing in July 1992. Nevertheless, foreign investors were only allowed to invest in retail joint-venture operations in six cities: Beijing, Shanghai, Tianjin, Tsingtao, Guangzhou and Dalian; and the five Special Economic Zones (SEZs): Shenzhen, Zhuhai, Shantou, Xiamen and Hainan. A maximum of only two large-scale joint venture stores were permitted in each location. The six major restrictive provisions governing foreign retail activities in China proclaimed in 1992 were as follows (Appendix 6.4):

- Foreign enterprises may take the form of equity joint venture or co-operative joint ventures with the majority shareholder being the Chinese partner. Wholly foreign-owned enterprises will not be permitted.
- The detailed proposal of the applying foreign enterprise shall be submitted by the regional governments to the State Council for approval. The qualifications of the parties to the joint venture shall be examined and approved by the newly formed Ministry of Internal Trade.
- The business scope of the foreign enterprise is restricted to the retailing of general merchandise and the commercial business of import and export. Engaging in wholesale business or acting as an import and export agency for another company is not permitted.

[1] For regulations governing foreign investment in China in general, please see Appendices 6.1, 6.2 and 6.3.

- General merchandise is the only kind of commodity that enterprises can import. The amount of such imported merchandise throughout the year must not exceed 30% of the turnover of the year. For importation of domestic electrical appliances, cosmetics, cigarettes, wine and beverages, approval formalities shall be completed in accordance with the relevant provisions of the State.
- Tax treatment shall be implemented in accordance with the State's policy that applies to the places where the foreign enterprise carries on the retail business. Income tax[2] will normally be at 33% with no tax-free period, as retailing will not be regarded as a production enterprise.
- Foreign enterprises shall have autonomy to purchase commodities for sale and fix their selling prices unless the state or local administrators of commodity prices stipulate otherwise.

The above regulations were formulated by the Chinese Central Government. However, these regulations were not strictly followed by local authorities. Many shopping malls in a lot of cities in China did not perform satisfactorily. Furthermore, most Chinese businesses were capital deficient and therefore finding a Chinese partner who could afford to fund the majority stake is difficult. As a solution to these problems, many local authorities creatively bent the Beijing rules and brought in a lot of foreign retailers without closely following the instructions from the Central Government (Virtual China Inc., 1999). They hoped that the introduction of experienced foreign retailers who possess management know-how and capital into their districts would boost economic activities, improve their local competitiveness and create employment opportunities. More than 200 sino-foreign retail joint ventures have entered the Chinese retail market through provincial and municipal governments during the period between 1992 and the end of 1999 (China World Trade Corporation[3], 2000). In contrast to this number, there

[2] Income tax in the Western world is a tax on an individual's personal income. The term 'income tax' in the context of China has a different meaning and is equivalent to 'profit tax' in the Western concept. This difference is a concomitant of the communist regime.
[3] China World Trade Corporation is the name of a website documenting a lot of materials about China's entry into the WTO. For the URL, please refer to the bibliography.

were only 20 Sino-foreign retail joint ventures that were approved by the State Council in the same period. According to Zheng (1998), those 'illegal' joint ventures were operated in one of the following disguised forms:

- Register as a Chinese company using the identity of the Chinese partner but the company is actually run by the foreign partner.
- The foreign partner first registers as a Hong Kong or Taiwanese company and uses this identity to form co-operative retail joint ventures with a Chinese partner[4].
- The foreign partner registers as a management consultant for a particular Chinese retail company but the retail company is practically run by the foreign partner. Sogo, a Japanese retailer, is an example of those foreign retailers who entered the Chinese market in this way[5].

6.1.1.2 The Emergency Decree 1997

The Central Government slowly realised that the situation of illegal sino-foreign retail joint venture activities had become unmanageable. In order to maintain the consistency of the *Foreign Investment in Retailing Policy* and the control of the local governments, the State Council, which is the highest organ of the Chinese government, issued an emergency decree in May 1997. This decree ordered all local authorities to stop approving projects involving foreign retailers without consulting the State Council. Moreover, foreign invested ventures were requested to hand in their licences for inspection on whether or not they had complied with the provisions set out in 1992, especially the rule on Chinese majority shareholder status. In August 1997, the Ministry of Foreign and Economic Co-operation (MOFTEC) published the *Notice of Information on Clearing and Rectifying Non-Experimental Foreign Investment Commercial Enterprises* by the Office of the State Council. This notice stated clearly that the licence of any retail joint venture without majority Chinese ownership would be revoked

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[4] Companies with such identities could enter the China market more easily because there are special laws and regulations governing foreign direct investment from Hong Kong and Taiwan companies. This furnishes such companies with more freedom and flexibility (Appendices 6.5 and 6.6).

[5] This piece of information was obtained from an informal interview with a foreign retail practitioner in China who wished to remain anonymous.

regardless of whether a license had already been issued or not. Nevertheless, a commercial representative in the Commercial Section of the British Embassy in Beijing pointed out that up to August 1999, none of the illegal retail joint ventures had received notification that their licences had to be revoked, although many such retailers were attempting seriously to formulate a solution to this order[6].

6.1.1.3 The Experimental Measures on Commercial Foreign-invested Enterprises announced in 1999

Two years after this notification was issued, MOFTEC and the State Economic & Trade Commission (SETC) announced the *Experimental Measures On Commercial Foreign-invested Enterprises* (Appendix 6.7), which was approved by the State Council, on 25th June 1999. The fundamental principles governing foreign retail activities were similar to those laid down in the provisions made in 1992, except that they signify the further opening of the retail and distribution market to foreign players. There are three major changes.

Firstly, the Measures abolished the prohibition on foreign investment in the distribution sector. However, the Chinese side of any sino-foreign wholesale joint venture must hold at least 51% share.

Secondly, Sino-foreign retail and distribution joint ventures can now be set up in the 11 locations permitted in the 1992 provisions, Beijing, Tianjin, Shanghai, Chongqing, all special economic zones, and all provincial or autonomous region capitals.

Thirdly, the onerous approval process of the establishment of Sino-foreign commercial joint ventures is substantially simplified by the Measures. The consent from the State Council is no longer required for every application, although its involvement is still necessary in certain circumstances (such as deciding on a majority foreign stake, or on the application of an already established joint venture who wishes to extend into the

6 Information obtained from the author's field work (interview).

retail and/or distribution market). Instead, MOFTEC and SETC are now held responsible for approving Sino-foreign retail and distribution joint venture projects (see Appendix 6.7 for details).

Apart from the three changes just mentioned, the Measures also set forth some more details regulating foreign retail and distribution joint ventures. The main concern is regarding the share distribution between the foreign partner and the Chinese partner, because in the past the rule that the majority shareholder in a Sino-foreign retail joint venture had to be the Chinese partner was largely ignored. According to the 1999 Measures, the Chinese partner of a retail joint venture that has more than three retail outlets must hold at least 51% of shares. Nevertheless, if after establishment the foreign partner has procured domestic products massively and can help expand the exports of domestic Chinese products by utilising its international network, it can then become the majority shareholder subject to the approval of the State Council. For foreign retail joint ventures with three or less stores, the Chinese partner must hold at least 35% of the shares. For distribution joint ventures, at least 51% of the shares must belong to the Chinese partner. No franchising or voluntary chains in which there is less direct management by the joint venture retail company, are allowed to participate in foreign retail or distribution joint ventures. Furthermore, all these joint ventures can only operate up to a maximum of 30 years, except in the midland and Western part of China, where they can operate up to a maximum of 40 years.

Commentators believe that the reason for the relaxation of regulations in the 1999 Measures on the operational and geographical scopes of Sino-foreign commercial joint ventures is the strong desire of China at that time to join the World Trade Organisation. At first glance, the 1999 Measures legitimise numerous previously forbidden practices, which in reality had proved difficult to control. Nevertheless, on a closer inspection, the Central Government's determination that the new Measures will be observed by both the authorities (whether district or local) and foreign investors, is embedded in the document (Virtual China Inc., 1999). In other words, this liberalisation is of a mixed nature.

6.1.1.4 Future Development alongside China's Entry into WTO

As China's WTO accession gathers momentum, the extent and speed of reform in its foreign economic and trade management systems will gradually increase. Laws and regulations that are not compatible with the provisions of the WTO will have to be changed. China has to establish a legal and regulatory environment that is conducive to fair competition and in line with international practices.

According to China World Trade Corporation (2000), one main reform that China will make is to increase the transparency of its system of examining and approving foreign investment. Moreover, the examination and approval procedures of foreign investment will be kept as simple, open and efficient as possible. However, there is a transition period, within which the relevant regulations will be changed or abandoned, for different sectors.

In relation to the retail and distribution sector, China made comprehensive and specific commitments in the WTO accession agreement. Foreign companies will be allowed to import and distribute most products within three years of accession. Restrictions on virtually all products will be phased out within five years. Regulations on the percentage of equity ownership, business scope, number of distribution service suppliers and geographic areas will be progressively abolished in three years. China has also agreed to open a number of related logistical functions such as maintenance and repair, storage and warehousing, packaging, trucking, air courier services, freight forwarding, rental and leasing, advertising, marketing and customer support to foreign investors in three to four years. Furthermore, franchising will also be gradually permitted within five years.

China World Trade Corporation (2000) states that the further opening of China's trading and distribution system to foreign companies will accelerate the economic growth in China and improve response to the needs of Chinese consumers.

6.1.2 Problems with the Existing Legal and Regulatory Infrastructure

The above is an account of the development of the regulatory infrastructure over the last eight or nine years. The regulations governing foreign direct investment in retail and distribution sectors have been continuously revised, refined and modified. Taking an optimistic viewpoint, the new development should furnish both existing and potential foreign retailers and wholesalers in China with more freedom. However, the Chinese legal system is still far from perfect. Moreover, there will be a transition period of about three to five years before all the legal restrictions on foreign investment in the retail and distribution sectors will be completely eliminated (as discussed earlier). Therefore, the new retail and distribution landscape in China has yet to be witnessed.

The author's interview results demonstrated that there are problems inherent in the legal and regulatory infrastructure with regard to foreign retail and wholesale investment in China. When the respondents were asked to describe the major problems related to the legal and regulatory infrastructure in China that they encountered, three major problems were found: inconsistency in policies and immature legal system, tight control on foreign retail activities and discriminatory practices towards foreign operators. These problems will be discussed in detail in the following sections.

6.1.2.1 Further Details of the Interview Results

Five out of the thirteen retailers interviewed mentioned that inconsistency in policies and immature legal system were two major problems. Four of these five retailers claimed that tight control on foreign retail activities was also a main obstacle to the development of their business in China. Among these four retailers, two are from Europe, one from America and the other one from Hong Kong. Discriminatory practice was recognised by six retailers as another major shortcoming of the legal and regulatory infrastructure in China that affect their retail business. Two of these five retailers are from Europe, three from Hong Kong and one from Japan. There are two retailers who mentioned all the above three problems during the discussion on legal and regulatory infrastructure. One is of a European origin and the other is of a Hong Kong origin.

It appears that European and Hong Kong retailers were more open in discussing issues relating to legal and regulatory infrastructure, whereas their other Asian counterparts were more reserved. There was only one European retailer who refused to discuss this topic whereas there were four Asian retailers who refused to do so. This European retailer and three out of these four Asian retailers only stated that they had a good relationship with the government but refused to discuss anything further on legal and regulatory barriers to their foreign direct investment in China. Their relationships with the Chinese government will be investigated in more detail at the end of this chapter.

6.1.2.2 Inconsistency in Policy and Immature Legal System

As economic reform in China has been underway for more than two decades, the distribution sector has become one important area that China desires to modernise. However, China is deficient in capital and the relevant technology and management know-how that is required for distribution modernisation. Consequently, the introduction of foreign direct investment into the retail and distribution sector has become a very attractive and almost inevitable solution. Nevertheless, the Chinese government insists on keeping the activities of foreign retailers on its territory under control. These two antagonistic considerations, together with international pressure, have led to frequent and unpredictable changes in regulations and policies for foreign direct investments in the retail and distribution sectors. New direction could be introduced at any time. This makes it difficult for foreign retailers to predict the future and formulate an optimal medium-term strategy. The Chief Executive Officer of Company F commented,

> "Generally speaking, they want to open the market and continue the development. But you never know what is next with the Chinese government."

Furthermore, the Chinese legal system is immature. The indigenous legal philosophy and practice is inconsistent with the international one. For one and the same ordinance there is sometimes a discrepancy between the interpretation of a foreign retailer or lawyer and that of a local court. Therefore, it is difficult for foreign retailers to establish confidence in the Chinese legal system. Moreover, foreign retailers have to make a lot of effort to ensure the smooth running of their business in legal terms. Based on the author's interview results, foreign retailers are facing three particular problems that are related to the nature of the existing legal and regulatory infrastructure. These three particular problems are differences in legal practice, different political environments in different parts of China and additional municipal regulation of foreign retail direct investment.

Differences in Legal Practice

Company F considered the main legal obstacle to their foreign direct investment in China to be the Chinese legal system. They perceived it to be very different from international practice. In particular, Chinese judges were not accustomed to commercial business. In order to alleviate this problem, Company F invited judges to visit their sites so that they could have the system, rules and instructions explained to them. These visits have facilitated the understanding of the judges. This method did not however solve all the problems because it required the willingness of judges to go outside the law courts to experience the reality. Not all the judges were so enlightened. Furthermore, there is the possibility of moral hazard in that the situation may easily end up in corruption.

Because of the difference between Chinese and international legal practices, Company F employed both local (in-house) and foreign lawyers from Hong Kong. The foreign lawyers were not qualified to represent the company at court. However, they played an important role for the company in that they helped the company's local lawyers to compare Chinese and international law practices.

In fact, revision and modification of legal system is one of the items on the agenda of Chinese economic reform. Contract law was refined in October 1999 and at the time of writing constitutional law was also under review. Company F believed that the government was heading in the right direction, although time was needed for the system to take effect. However, there was still one major issue, described as 'a very big problem': bribery[7]. This, together with the discrepancies between the local legal system and the prevailing international practice has made the company sceptical about the trustworthiness of Chinese law.

The experience of Company F shows that the Chinese legal and regulatory system is sometimes unsystematic and unconventional when compared to the international legal practice that foreign retailers are used to. Besides the problems described by Company F, the author's fieldwork also suggests that there is another problem inherent in the existing legal system. Despite the promulgation of many laws and the modification of its legal system, the actual operating rules are not published and hence unavailable to foreign retailers. Lawyers who work with foreign clients claim that they have difficulties in accessing the content of the laws and regulations that apply to business operations (McClain and Cheng, 1995). These operating rules are contained in *neibu*, meaning internal documents, which are confidential. As the Vice General Manager of Company M put it,

> "Chinese legal issues are very difficult to know because all the important rules are in the form of *neibu*, which is only circulated internally among the relevant governmental departments. We never have a crystal clear understanding of what is going on."

Consequently, the actual rules in force may be applied capriciously, and at the discretion of the decision-maker.

Different Political Environments in Different Parts of China

The existence of *neibu* and the divergence in application of the actual rules also lead to a diversity of provincial legal practices. In addition to the confidentiality of the actual operating rules, Chinese laws regarding foreign retail operations are always construed in a very ambiguous manner (China World Trade Corporation, 2000). Even when the

[7] Bribery was an issue on which the author could not obtain any details from the interviewees and therefore will not be discussed further in the thesis.

relevant regulation can be found, provisions are always too equivocal to be certain of correct interpretation (McClain and Cheng, 1995). A specialist at the US Agricultural Trade Office (Guangzhou Office) maintained that the vagueness of the Chinese laws was a significant problem to foreign retailers' operations in China[8]. He further pointed out that cases were always treated individually and discretely. It is futile to refer to a similar case in the past because the verdicts of similar cases could be different. This is due to the fact that there is no systematic compilation of case-law precedents that would facilitate the interpretation of statues and regulations (McClain and Cheng, 1995).

The ambiguity inherent in legislation not only imposes an interpretation problem to foreign retailers, it also leads to different interpretations and thus variations in the implementation of the laws by government officials at district and local levels. The specialist at the US Agricultural Trade Office (Guangzhou Office) observed that officials in the north of China are generally more prudent in their interpretation. They perceive certain acts to be forbidden if not explicitly legitimised by law. By contrast, officials in the south tend to be more daring. The non-existence of a prohibition is deemed to be permission. Subsequently, there is more flexibility in the south, which is more conducive to the development of private enterprises[9].

The specialist at the US Agricultural Trade Office (Guangzhou Office) believed that this difference in attitudes is the result of geographical and historical factors in China[10]. There is a common Chinese saying, 'the mountain is high and the emperor is far away', meaning that the more distant a central authority is, the more difficult for the Central Government to regulate and monitor the local authority, and hence more 'flexibility'. As illustrated in before, local authorities also have a record of deviating from the instructions of Central Government depending on the attitude and traditions of the particular local authority. Several speakers at San Francisco Conference 1995 expressed concerns about the extent to which Central Government could put through their policies

[8] Information obtained from the author's interview.
[9] Information obtained from the author's interview.

at local level. They were sceptical about whether laws and regulations formulated at the national level were being routinely enforced at the local level if local officials felt that the enactment was in conflict with local interests (McClain and Cheng, 1995). Furthermore there are many major coastal cities in southern China. They have always been the gateway between China and the outside world. Historically, they have been the locations in which commerce and economy have been most prosperous prior to the formation of the PRC. They have rarely been closed to foreign business culture.

Some informants perceived that the political environments in the south and that in the north of China are different. Economic factors play a more important role in Shanghai than in Beijing. In Shanghai, economic performance is a big consideration. The Shanghai government is very ambitious about reforming its commercial status and believes that retailing is a crucial area to develop. A lot of support is given to local retailers while a considerable effort is made to work and communicate with foreign retailers such that modern retail knowledge and know-how is transferred to local retailers. For example, arrangements are made by the government to send local retail candidates abroad for training with the help of foreign retailers.

In comparison, officials in Beijing are more politically conscious as befits a capital city. Relationships and networking are of higher priority than economic results. Their role in the development of a retail sector is regulatory. Carrefour, a French hypermarket, offers a good example to illustrate this point. Most players in the industry consider Carrefour to be the most profitable food retailer in China, although there is a lack of published statistics. It has operations in both Shanghai and Beijing. The joint ventures in neither place were approved by the Central Government at the time of formation. In Shanghai, its partner is one of the leading local supermarket chains and the operation has been very successful. It has experienced no obstacle to expansion. However, it had been prohibited from expansion in Beijing albeit it was equally successful in economic terms. The official reason for the restriction was non-compliance with the requirements for joint

[10] Information obtained from the author's interview.

ventures since inception. A significant amount of effort and time were taken by Carrefour to rectify this problem[11].

The inconsistency in applying the law by different provincial governments complicates market entry of foreign retailers into different parts of China. Apart from the necessity of handling the low transparency and accessibility of the Chinese law on foreign direct investment, foreign retailers also need to learn about the different political environments in different regions, and hence enter different regions in China with careful preparations.

Recently, the Central Government has tried to hold a tighter control on the provincial governments (as discussed before). For examples, February 2001 saw the beginning of a prolonged negotiation of Carrefour with the Central Government over restructuring of its businesses in China. None of all the 27 outlets of Carrefour were approved by Central Government but instead relied on the goodwill of local authorities. This non-compliance to the rules of the Central Government eventually triggered an order to Carrefour to restructure its businesses. The Central Government however had not decided on what Carrefour had to do at the time.

Beijing's crackdown on the retail sector in 1998 and 1999 resulted in the closures of 35 retail outlets of various foreign retailers. Several foreign retail groups also had to sell some of their shares to Chinese partners because of the crackdown. Industry experts are unsure about what this restructuring order on Carrefour will involve but they believe Carrefour's plan to open ten more stores in China could be hampered. They also consider this move is a warning to other foreign retailers that Beijing intends to enforce Central Government regulation more actively before joining the WTO (Financial Times, Feb 07 2001). Whether or not Central Government's determination to enforce its regulations at provincial level will eliminate the inconsistency in implementing the law has yet to be seen.

[11] This piece of information about Carrefour was sourced from a foreign retail practitioner in China who would like to remain anonymous.

Further Municipal Regulations of Foreign Retail Direct Investment in Shanghai

Besides the Central Government provisions, each municipality has its own further regulation of foreign direct investment in the retail sector within its domain. This can be illustrated by the following case[12].

There has been a surge in foreign FMCG retailers in Shanghai City since 1995. They use various formats: hypermarket, supercentre, cash and carry, warehouse club, or the like. In China, all these formats are collectively called *damaichang*, which literally means a big marketplace selling a very wide range of products at reasonably low prices in a clean and modern self-service environment. (Such nomenclature reflects the fact that few Chinese consumers are able to distinguish differences in retail format.) Based on research carried out by international management consultancy in Shanghai, there were 27 *damaichang* outlets in Shanghai City in June 1999, of which 26 were foreign-Sino joint ventures[13]. In the absence of any development plan, the rapid inflow of foreign direct investment in retailing and the speedy competitive response of local retailers in Shanghai resulted in chaos. In 1999, the Commercial Commission of Shanghai Municipal People's Government realised that growth was out of control. Consequently, they decided to limit the number of *damaichang* outlets occupying ten thousand square metres or above to 30 within the outer ring road in Shanghai City.

Municipal legislation has also suffered from problems similar to those encountered at the national and provincial level. Recognition of foreign retail investments at municipal level can be subject to change at short notice. There is also inconsistency of policy at district level. Laws in different districts and towns within even the same city are not standardised. As an example, the rules on product licensing in Pudong are different from those in Putao, two different districts of Shanghai city. Although the lack of national

[12] The case material was obtained from author's interview with an international management consultancy firm in Shanghai and the deputy director of the Commercial Commission of Shanghai Municipal People's Government.

procedures for product licences is normal in Western countries, variation within the same city in China was criticised severely by foreign retailers.

Furthermore, disagreements between different local authorities within the same city over certain regulations are sometimes found. This is because of a conflict of interests. When the regulation limiting the number of *damaichang* outlets to 30 was issued, various reactions among different local authorities to this rule occurred[14]. Under the city government there are two further layers: district and town. Each has considerable interest in foreign direct investment in their domain because of the increase in income through taxes and higher employment, and therefore strengthened performance within their own particular area. Due to the change of regulation, they were no longer able to bring in as much direct foreign investment as they desired. The consequence was competition among the local authorities for the remaining quota. For example, a certain town would take immediate action to demolish some old factories and redevelop the site to make it suitable for large-scale retail stores in the hope of pre-empting the attainment of permission to introduce a *damaichang* by another town.

6.1.2.3 Tight Control on Foreign Retail Activities

As mentioned before, China has only partially opened its retail and wholesales market to foreign players, although a gradual relaxation in restrictions is seen. Therefore, the legal procedures for foreign retailers to set up their business in China are onerous.

> "There are countless barriers to doing business in China. The red tape is endless and there are fees for foreign companies, public services, taxes, etc.,' claimed the Vice President, Asia Region, of Company E.

In fact, the empirical study showed that compliance with government regulations is considered by foreign retailers to be the most complicated aspect of setting up joint ventures in China. There are many regulations for foreign retailers to observe and there

[13] It has to be noted that not all of these 27 *damaichang* outlets sell food products. However, a name list was not available for public access.
[14] According to the Chief Purchasing Officer of Company F

are many forms to fill in. The Chinese government is highly involved in the process of screening and granting permissions to foreign retailers. As pointed out by the Chief Purchasing Officer of Company F, the legal procedures in Central and Eastern Europe are much simpler than those in China. Obtaining a business licence is relatively easy in Eastern Europe whereas the process of getting a business licence is complicated in China. For instance, Company C, a Japanese retailer who at the time of interview has one outlet in Guangzhou, wanted to open new stores but one of its directors pointed out that it would take a long time before any solid decision about expansion could be made because of the prolonged application procedures for business licences. The Chief Purchasing Officer of Company F described the situation of government control in the following way:

> "It seems that you are given the freedom once you get the business license but in reality you do not have the freedom. You will find that the freedom is denied to you when you really start developing your retail business."

Similar experiences were found in cases involving Asian retailers in China. However, Company A, a Hong Kong supermarket chain, showed a milder attitude towards the legal and political complications. The company admitted that there are many steps involved and getting permissions for a joint venture in China is a prolonged process but they did not consider the legal procedures to be a problem. They believed that bureaucratic red tape is reducing gradually. Guidelines for approval procedures regarding conditions under which local authorities accept and register a foreign retailer's application have become clearer. Co-ordination among different governmental departments has improved and there is now a deadline system for government departments to respond to applications[15].

Many steps are involved in the application process for a foreign retailer. In the past, a foreign retailer had to visit a vast array of different departments in turn during the

[15] Source: Director of Company A

process. This involved the expenditure of a considerable amount of effort and time before the whole process is finished. In order to increase efficiency, a one-stop office has been set up in Guangzhou to accommodate representatives from each of the relevant governmental departments to deal with and follow up foreign retailers' applications[16].

Owing to the continuous streamlining of governmental structure and procedures with regard to the application process of Sino-foreign joint ventures, Company A claimed that the preparation of feasibility reports, and not the approval process, has become the most time-consuming aspect in the setting up of the joint venture.

6.1.2.4 Discriminatory Practices towards Foreign Operators

Four out of eight Asian retailers and two out of four European retailers pointed out that the retail market in China at the time of interview was not a level playing field. A detailed account of their perception on unfair treatment is described below.

Local retailers usually enjoy lower rent for land than foreign retailers. Economic reform has led to the re-structuring of state enterprises. In the past, these state enterprises were entirely owned by the state and their economic activities were controlled by government officials (Reeder, 1984). As part of the reform process, *gufenji* was introduced: shares were issued and owned by different interested parties. However, the majority shareholders of most large scale local companies are stakeholders that have emerged from government related organisations. It is widely believed that 'the form is changed but the substance remains similar'. It is alleged that this enables the now private owners to obtain land at a much lower cost than foreign retailers because of their continuous close relationship with state officials. However, the four local food retailers the author interviewed denied that they obtained free land or sites from the state and they had to

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[16] Source: Director of Company A

pay an economic rent[17]. Nonetheless, foreign retailers continue to believe that local retailers pay rent that is lower than that which foreign retailers can negotiate because of *guanxi* (relationship)[18].

Three executives of the foreign retailers interviewed (who have either worked in China for a significant period of time or are indigenous Chinese and have worked in the industry for a considerable amount of time) explicitly claimed that most local retailers have ways of evading tax by, for example, under/over-invoicing. Consequently, although foreign retailers are granted a lower corporation tax rate domestic retailers more than make up for difference through lower land rents and tax evasion. The Chief Non-food Purchasing Officer of Company F revealed:

> "Basically there are a lot of local competitors doing a lot of things we can't do- manipulating invoices, low rent, low labour costs, sometimes they don't pay tax, sometimes they cheat. In this case, their cost of merchandise drops and if we add all these up, our price can't be competitive anymore."

Furthermore, foreign retailers believe the Chinese government is stricter with them than with local retailers. The regulatory bodies tend to turn a blind eye to the issue of whether a local retailer complies with the regulations or not. When a breach of regulation is discovered, there is a less serious consequence for a local retailer. According to the General Manager of Company K, there were always officials coming to their outlets to check whether they had complied with all the regulations or not. If they were caught for non-compliance a fine would normally be imposed, but officials could stop them from carrying on business until all non-compliance was rectified. The interviewee claimed that the government officials did not check the local retailers as often as they check them.

[17] Apart from the 13 foreign companies and those independent organisations that are listed in Chapter 4, the author also chatted informally with four Chinese food retailers during her fieldwork. They are not listed in Chapter 4 because they were not meant to be formal interviews.

[18] The concept and meaning of *guanxi* is discussed in more detail in section 6.2.3.2.

6.1.3 Prospective Legal and Regulatory Development

Economic reform in China will undoubtedly accelerate after China's entry into the WTO in December 2001. China has long recognised the importance of foreign direct investment to the modernisation of China. In October 2000 State Councillor of China Wu Yi re-emphasised this point. She stressed that foreign capital benefits the Chinese economy not only in terms of growth rate but also in terms of structural adjustment and industrial optimisation (Chinafair, 2000). In the distribution and retailing sector, abolition of the many regulations that prohibit and restrict foreign participation in trading and distribution activities will undoubtedly improve the efficiency of distribution in China. Efficient distribution is essential to the success of any business in China that involves the movement of products from suppliers to customers. Distribution activities include import and export trading, shipment and delivery of goods, order processing, invoicing, warehousing, wholesaling, the establishment of distribution networks, retailing, and after-sales service. Economic reform in China necessarily entails the replacement of state-owned and centrally managed trading and distribution systems with more flexible local and regional distributors. At the moment, China's distribution system is at a critical stage in its development (China World Trade Corporation, 2000). China has promised in the WTO accession agreement that modernisation in distribution and retailing will gain further momentum and most commentators believe that large scale foreign retailers will play an important part in the process.

The liberalisation and gradual abolition of restrictions on foreign participation in the distribution and retail sector, nevertheless, does not imply that all the difficulties relating to legal and regulatory issues will immediately disappear for foreign retailers.

Foreign retailers should also pay attention to the vagueness of the language used throughout the foreign direct investment policies in China, even though the tone and agenda of recent policy appears to be responsive to some of the major difficulties that foreign retailers face (China World Trade Corporation, 2000). China World Trade

Corporation warns that foreign investors should be aware of the possibility of watering down of the benefits and reforms proposed as they enter.

On the other hand, the Chinese government has endeavoured with certain measures to guard against the domination of foreign retailers in the retail and distribution sector. The *China Business Times* reported on 29 May 2000 that foreign retailers were expected to control a significant market share after China join the WTO (China World Trade Corporation, 2000). The paper further commented that the retail sector was one of the weakest areas of China's economy and is highly vulnerable to foreign competition. A director with the Beijing Municipal Commerce Committee believes that the fundamental solution is scale expansion and institutional streamlining (China World Trade Corporation, 2000). Therefore, the Beijing municipal government plans to consolidate the 3000 or so local retail enterprises in the city into about five supermarket groups. The director also claimed that construction of distribution centres, development of e-commerce within the existing retail enterprises and service improvement will follow the consolidation. The Shanghai municipal government shares the same view and has, in fact, already set up five large scale local retail chains via mergers, alliances, trustees and shareholding in 2000 (China World Trade Corporation, 2000).

Clearly China's entry into the WTO does not remove local competition-fair or unfair for foreign retailers. It will certainly bring along with it further relaxation and gradual softening of legal and regulatory restrictions on foreign direct investment. It will also create a new competitive landscape in the retail and distribution sector. Most importantly, how the law and regulations that govern the actual operation of foreign retailers are implemented is yet to be seen. It will also take time for the Chinese legal system to mature and for indigenous and foreign business people to adapt and adjust to each other's business practices.

6.2 Market Entry Mode: Foreign Direct Investment/Joint Venture

In China, there are three principal structures for foreign direct investment: Sino-foreign equity joint ventures, Sino-foreign cooperative (contractual) joint ventures and wholly foreign owned ventures. As mentioned earlier, wholly foreign owned ventures are not allowed for foreign direct investment in retailing. Therefore, this section mainly focuses on the two types of joint venture.

International joint ventures are a common topic of analysis in international management, strategic management, financial management, international marketing, international accounting, and international business law literature (Konieczny and Petrick, 1994). Different scholars have used different perspectives to explain their existence and characteristics (Pan and Li, 2000). Transaction costs, bargaining power, social institutional processes and cultural differences are some examples of the analytical approaches that have been adopted. At the same time, different studies on international joint ventures have different focuses. The main themes include the influences of differences in strength and strategic objectives between partners on their bargaining approaches, choice of joint venture partners, success and failure factors of international joint ventures and other dimensions concerning co-operative strategies between partners (Harrigan and Newman, 1990). A lot of such research has also been conducted on Sino-foreign manufacturing joint ventures. However, it appears that there has not been much research on joint ventures in the retailing sector in China.

This thesis does not aim to investigate the details of joint venture, but to examine the phenomenon as an element in the internationalisation process of food retailers in China, particulars market entry strategies of retailers in China. Those issues include the type of joint ventures that foreign retailers adopted, partner selection and contribution of each partner, equity ownership of foreign partners, share of managerial control, and relationships with their Chinese partners.

6.2.1 Research Results

The interview results regarding the nature of local partners, type of joint venture and proportion of shareholding of each partner are summarised in Table 6.1. The research results on other aspects will be presented below in the appropriate sections.

Table 6.1 Summaries of Interview Results on Joint Venture Structure

Foreign Retailer	Nature of Local Partner	Type of JV
A		Equity & Cooperative
B	Non retailer, state-owned	Equity
C	Under provincial government	Equity
D	Owned by Commercial Bureau of the city	Equity
E		
F	Stated owned conglomerate with hotel as its major business, also have taxi and supermarkets	Equity
G[1]	A real estate company that own a shopping mall in the city	Equity
H	A company that supplies fresh vegetables	Cooperative
I	A company belongs to Ministry of Internal Trade, non-retailer	Equity
J	Non-retailer (one in each region)	Equity
K	A trade association, get it thru Chinese govt., some experience in retailing	Equity
L	A company in alcohol industry	Equity
M	2 companies related/under local authority	Equity

Foreign Retailer (con't)	Foreign Shareholding	Contribution of Local Partner	Country of Origin
A	majority	cash, services, assets	Asia
B		capital, legal issues	US
C	80%		Asia
D	70%	capital, legal issues	Europe
E			Asia
F	60%	capital	Europe
G	49%	site	Asia
H		land/site	Asia
I	65%	capital, legal and govt. issues	Europe
J	confidential		Asia
K	49%	capital, advisory, acts as supplier	Europe
L	49%		Asia
M	42%	40% and 18%	Asia

[1] Company G claimed that they had 49% shares in their joint venture and therefore it should be an equity joint venture. However, according to the Deputy Director of Commercial Commission

of Shanghai Municipal People's Government, Company G's retail business in China was a cooperative one. The author was unable to obtain further information regarding its form of joint venture from Company G.

There are no entries in some of the boxes in the above tables. This is due to the unwillingness of the interviewees to disclose information. Company J explicitly stated that the holding of shares between themselves and their partners was confidential. Company E made it very clear that they would not discuss anything related to their foreign direct investment structure when they accepted the author's request for interviews. With other companies, although information related to the joint venture structure and partners was obtained, the author experienced difficulty in extracting further details. The reluctance of foreign retailers to discuss this topic openly suggests that the identity of their partners and the division of contribution between themselves and their partners are of strategic importance to the success of their retail ventures in China. The comment of the Chief Non-food Purchasing Officer strongly illustrates this point,

> "To have the right partner is the most important and it is the critical success factor for any joint venture in China. If you don't have the right partner, you are dead already."

6.2.2 Two Types of Joint Venture in China

In general, joint ventures are defined as legally and economically distinct organisational entities created by two or more parent organisations that jointly invest capital and other resources to pursue certain strategic objectives. Joint ventures are further divided into two different kinds in China. The two kinds are called Sino-Foreign Equity Joint Venture and Sino-Foreign Cooperative (Contractual) Joint Ventures.

6.2.2.1 Sino-Foreign Equity Joint Ventures

Sino-foreign equity joint ventures are enterprises established in China with joint investment from foreign companies, enterprises and other economic organisations or individuals; and from Chinese companies, enterprises or other economic organisations.

This is the oldest form of foreign direct investment in China. The law governing this kind of joint ventures dates back to 1979[19].

All parties involved in a Sino-foreign equity joint venture jointly invest in, operate and share the risk of the venture. Investment can be in the form of cash, buildings, machinery, equipment, the right to use the work site, industrial property and exclusively-owned technology. Profits and losses are shared by all shareholders in the ratio of their contribution to capital. The joint venture must adopt the form of a limited liability corporation and the board of directors is its supreme body of governance.

6.2.2.2 Sino-Foreign Cooperative (Contractual) Joint Ventures

Sino-foreign cooperative joint ventures are also called Sino-foreign contractual joint ventures. Such ventures are enterprises established in China with investment or conditions for cooperation jointly offered by foreign companies, enterprises, other economic organisations or individual and by Chinese companies, enterprises or other economic organisations. The law governing this type of ventures was passed in April 1988[20].

The main difference between cooperative joint ventures and equity joint ventures is that profits and losses are not shared according to the ratio of each party's contribution to capital. The rights and obligations of all parties involved in the cooperative venture are all clearly defined in the contracts that are signed by all parties. Examples of rights and obligations include the provision of investment and conditions for cooperation, the distribution of profits or products, the sharing of risks and losses, the form of operation and management, and the ownership of property at the termination of the contracts.

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[19] See Appendices 6.8, 6.9, 6.10 and 6.11 for laws and regulations of Sino-foreign equity joint ventures in China.

[20] See Appendices 6.12, 6.13 and 6.14 for laws and regulations of Sino-foreign cooperative (contractual) joint ventures in China.

The cooperative venture structure avoids the issue of valuation of foreign technology and equipment that has derailed many equity joint venture negotiations (Beamish and Spiess, 1993).

In most Sino-foreign cooperative joint ventures, the foreign party provides all or most of the funds while the Chinese side offers land, workshops, usable equipment, facilities, and sometimes a certain proportion of funds. Furthermore, the foreign and Chinese parties involved usually define in their cooperative joint venture contract that when the cooperation terminates, all assets of the venture will be owned by the Chinese party and that the foreign party is given priority to recoup its investment within the duration of cooperation. This arrangement is attractive to many Chinese enterprises and foreign investors because it satisfies both the need of Chinese enterprises for sources of investment and the desire of foreign investors for recouping their investments.

6.2.2.3 Type of Joint Venture Adopted by the Companies Interviewed

Except Companies A, E, G and H, all other companies took the form of equity joint venture. Nevertheless, Company D said that they desired to transform the joint venture into a cooperative joint venture in the future because cooperative joint ventures offer more flexibility and the manner in which the joint venture functions depends on the way the contract was written.

Company A stated that they had both equity and cooperative joint ventures in China but they preferred equity joint venture. Company A believed that real partners in a joint venture should contribute to the investment and at the same time share risk and return. They perceived that an equity joint venture offers the simplest arrangement that could reflect the principle of sharing. A cooperative joint venture, by contrast, does not always reflect this principle. Company A pointed out that in some cooperative joint ventures, the Chinese side provided land and arguments always resulted because of difficulty in evaluation of the land. There is also difficulty in evaluation of technology in cases that one partner contributes technology to the joint venture.

As mentioned in Table 6.1, Company G appears to have an equity joint venture but another source claimed that they had a cooperative joint venture. No further information about the kind of joint venture was obtained. On the other hand, Company H stated that their business in China was a cooperative joint venture.

Companies A and F pointed out that they always preferred to take the form of wholly owned subsidiary when they made foreign direct investments because of issues relating to control and problems with managing relationships with partners[21]. At the time they entered China, the Chinese law forbade wholly foreign owned subsidiaries and therefore they had to enter the market with joint ventures.

The results of the present research are consistent with those of joint venture research that is not directed towards the retailing industry. Equity joint venture is the most popular form of joint ventures in China (Mills and Chen, 1996). Western companies prefer less cooperative joint ventures although it is still an important form of joint venture in China (Mills and Chen, 1996).

Apart from the reason offered by company A, there is a plausible complementary explanation for the preference of the majority of the respondents on equity joint venture over cooperative joint venture. The laws governing cooperative joint ventures in China were only passed in 1988, which was almost a decade after the time when those governing equity joint ventures were passed. Consequently, the laws covering cooperative joint ventures are not as clear and well developed as those for equity joint ventures (Mills and Chen, 1996). Therefore, foreign companies perceive equity as a relatively secured and effective means to protect their interests (Luo, Shenkar and Nyaw, 2001), especially when they are unfamiliar with the Chinese environment and the Chinese business culture. This also explains why those retailers who adopted the form of cooperative joint venture in the author's study were from Asia, especially the overseas

Chinese, who are relatively more familiar with the Chinese business context. This tenet of a lack of a well-developed legal framework on cooperative joint venture activities and unfamiliarity of foreign retailers with the local business context may also serve to explain why Company D did not start as a cooperative joint venture in China but adopted the equity form at the time of first entry and only started considering changing to a cooperative form, which offers more flexibility, after gaining some years of operational experience in China.

6.2.3 Partner Selection and Contribution of Each Partner

According to the author's field study (Table 6.1), the local partners of all the eleven foreign retailers who gave information about the nature of their local partners were non-retailers. Most of these local partners, furthermore, were either state-owned or associated with local authorities that had strong regional influence on trade and retail policy development and implementation.

When asked about the main contribution of their local partners, three (two of them were European retailers and the other one was American) of the nine retailers who were willing to discuss this issue stated that the main role of their local partners was to deal with the government and legal issues, such as the legal process of obtaining a business licence. The president of Company D responded to this question in the following manner,

> "I will say his contribution is to get us the licences. That's supposed to be his contribution."

The General Manager of Company I made a similar comment,

> "Apart from a contribution to capital, the main contribution of our Chinese partner is that they develop and maintain good relationships with government and deal with most legal-related issues for our joint venture. Our partner can do a lot of things (on this aspect) for us."

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[21] These issues are discussed in further details in sections 6.2.4 and 6.2.5.

The Vice President of Company B also stated that the major contribution of their local partner was to obtain the business licence for the joint venture.

Four retailers, one Asian and three from Europe, were willing to discuss further the criteria by which they chose their local partners. Among these four retailers, three of them explicitly stated that they preferred to choose non-retailers as their partners. The reason was that they wanted a high degree of control. Retail partners tend to bargain for a significant proportion of control of management of the joint venture, which was not desirable from the foreign retailers' point of view because foreign retailers do not want to have obstacles in putting through their own retail concepts in China. The Chief Operating Officer of Company F stated,

> "Retail partners will always want to talk to us and always want managerial control. And this is what we cannot accept. We want to put through our system and have the last say and decide everything."

Nevertheless, the Chief Non-food Purchasing Office of Company F and the General Manager of Company K pointed out that they would not mind if their partners had a little bit of experience in the retail industry because in that case, their local partners would not bargain too much for power and at the same time they would be more knowledgeable about what licences to obtain and how to obtain them and be more understanding and patient during the development stage of the retail joint venture.

Another criterion that foreign retailers used in choosing local partners was the amount and kind of contacts and relationship that the potential partners had with government at different levels. Three retailers claimed that this was their main concern in choosing partners. Compared to this criterion, the nature of their partners' business in China was relatively irrelevant.

As mentioned before, the retail industry in China has not gone through the modernisation process as the retail industry in the Western world has. Foreign food retailers have developed their own retail concepts, formula and expertise, which they perceive as a source of their competitive advantage. Indigenous Chinese retailers lag behind in terms of retail know-how when compared to their Western counterparts. Consequently, foreign retailers perceive that local retailers could hardly offer any critical resources to the operation of the retail joint venture. Foreign investors want to put through their own retail system when they undertake foreign direct investment. However, one big obstacle in establishing a retail business in China is the legal and political environment. As explained earlier in this chapter, the legal system in China is radically different from those in most Western countries. The need for government support is essential in running a business in China. Retailers must be able to interact diplomatically with local regulators and government officials because their protection from the vagaries of Chinese law and regulation is important (Si and Bruton, 1999). Foreign retailers lack this expertise and this is what they need most from the Chinese partners. Chinese partners can bring to Sino-foreign retail joint ventures a clear understanding of the local circumstances, culture and politics, which complements the retail expertise of the foreign retailers.

In China, local provincial or metropolitan governments usually play the most important regulatory role (Child and Markoczy, 1993). The most suitable Chinese partners for foreign retailers are therefore those with good relationships or association with authorities at different levels. The present study shows that foreign retailers share the same perception of the role and importance of their Chinese partners. Seven retailers provided some details of their Chinese partners and these details are presented below. Due to confidentiality, the names of the Chinese partners of foreign retailers are not disclosed. Pseudonym names are assigned to each of them. Moreover, in order to further protect the anonimity of both the foreign retailers and their Chinese partners, no reference to the identity (even their pseudonym identities) of the corresponding foreign partner is made.

6.2.3.1 Nature of the Chinese Partners of the Interviewed Foreign Retailers

Company 1 was a state-owned hotel group. They had business activities in many cities in China. They were approached by their foreign retail partner and a decision was made to form a joint venture together to develop a retail chain in China.

Company 2 was a holding company with three trading companies. The company was a vehicle for investing in the retail joint venture while it had a little retailing experience. They were also one of the suppliers to the retail joint venture. Memorandum of understanding was first reached between the Ministry of Trade of China and that of the foreign partner's home government. Then, the foreign partner of the joint venture concerned approached the Chinese Central Government. The Central Government, in essence MOFTEC, introduced Company 2 to the foreign retailer.

Company 3 was a company that reported to the commercial committee of the city in which it operated. The commercial committee is a governmental organisation that handles all the business enterprises in the city. According to a respondent, the commercial committee had very strong legal and political influence on the entrance of foreign enterprises. The respondent put it,

> "If they (the commercial committee) want to keep you out, you won't get into the city. I go to the other cities and I meet with the commercial committee people. If they like us and want to work with us, okay and we could go ahead with our entrance plan. If not, you can forget it. That's how it works."

Company 4 was a company that belongs to the Ministry of Internal Trade in the city in which the joint venture operated. Chinese Central Government recommended Company 4 to the foreign retailer partner.

Company 5 and Company 6 were state-owned companies. The foreign retailer concerned approached the municipal government of the city in which the joint venture was located. The municipal government introduced Company 5 and Company 6 to them. The joint venture had the same Chinese partners for all their outlets in one city.

The founder of the foreign partner of Company 7 and Company 8 always maintained contacts and good relationships with the Ministry of Internal Trade, under which there was Company 7. Company 7 always wanted the foreign partner to develop a large scale supermarket in the city in which it was located. Therefore, they suggested a site in the city in which it could be located to the foreign retailer. The foreign retailer was interested in the project and the local government further introduced Company 8, which was under the local government's jurisdiction. Then these three companies became partners and formed the retail joint venture.

Company 9 was a company owning a shopping mall. It was a subsidiary of another company that was under the control of the provincial government. Company 9 approached their foreign partner and formed a joint venture.

From the case studies presented above it is clear that the Chinese partners of most foreign retailers were well connected to the authorities at various levels. Obtaining support from political authorities appears to mean buying some insulation from the many legal and political difficulties for foreign retailers in China. This is due to the importance of *guanxi* in social and business activities in Chinese society. Such importance is illustrated by the remark of the Chief Food Purchasing Officer of Company F, "What one needs to have to be our partner is to have the (political) contacts." The Buying Manager of Company J made a similar comment,

> "What business our potential partners do is not central to the decision in choosing the partner...we mainly want to gain from their relationships with different authorities."

The President of Company D also pointed out,

> "Exactly what our partner does, I am not terribly interested in. I just want them to get us the licences."

6.2.3.2 Significance of Guanxi

Child and Markoczy (1993) define *guanxi* as the quality of a personal relationship outside an individual's immediate family. *Guanxi*, as mentioned above, is widely recognised as an important element in Chinese society. It is based on personal relations and exchange of favours. When a situation arises that is beyond the capacity of an individual, one's *guanxi* network can be mobilised to achieve the desired results (Redding and Ng, 1982 in Park and Luo, 2001). It is critical for businesses, both local and foreign, in China to understand and appropriately utilise *guanxi* in order to gain an advantage over competitors (Park and Luo, 2001). When *guanxi* is put in the business context, the norm of reciprocity applies.

Park and Luo (2001) suggest that there are four features that characterise a *guanxi* network. First, *guanxi* is transferable among different parties through a common connection in the middle. Secondly, it is reciprocal. A favour is expected to be returned with another, not necessarily of the same value, at some future date. Thirdly, it is intangible. *Guanxi* members are tied together by a code of reciprocity and equity that is invisible and unwritten. The long-term viability of *guanxi* depends on the commitment of the *guanxi* members to the *guanxi* and to one another. The range and frequency of exchanging favours also depends on the individual's own choice. Fourthly, *guanxi* is utilitarian rather than emotional. It is based on exchange of favours instead of emotional attachment. Therefore, friendship is not always involved, albeit friendship can reinforce the commitments of the *guanxi* members.

In Chinese culture, having *mianzi* (face), is perceived to be highly important. A person's *mianzi* is determined by one's position, credibility, honesty, reputation, power, income or social network (Park and Luo, 2001). *Mianzi* forms the root of *guanxi*. Maintaining *mianzi* at a certain level is essential in order to successfully cultivate and expand a viable *guanxi* network. Manipulation of the dynamics within a *guanxi* network becomes easier once a person has strong *mianzi*. Therefore, members of a *guanxi* network will strive to maintain his *mianzi* by observing the rule of reciprocity because failure to do so will damage one's reputation, which in turn leads to a humiliating loss of prestige or *mianzi*. Consequently, the rule of reciprocity establishes a structural constraint that restrains self-seeking opportunism and preserves social capital within an existing *guanxi* network structure (Coleman, 1990 in Park and Luo, 2001).

In the Chinese business context, transaction often follows successful *guanxi*, while in Western countries a relationship more usually follows successful transactions (Park and Luo, 2001). Therefore, *guanxi* is a valuable resource for individuals and firms in China to induce cooperation and govern relationships between firms efficiently. Due to the existence of uncertainty and confusion in China's administrative structure, firms develop and manipulate *guanxi* to fill structural holes and alter the existing network structure (Burt, 1992 in Park and Luo, 2001), which in turn gives rise to protection against arbitrary state intervention. The possession of *guanxi* with government agencies or officials is especially crucial for fulfilment of enterprise targets[22] (Child and Markoczy, 1993). *Guanxi* provides a means to counterbalance the cumbersome and ambiguous Chinese bureaucratic rules by utilising one's personal relationships. Nevertheless, cultivating and sustaining *guanxi* with government officials is costly because of the reciprocal and utilitarian demands. A deep understanding of Chinese political cultural and a considerable investment of time are also needed in establishing *guanxi*. Therefore, building and utilising *guanxi* with government officials to circumvent bureaucratic and political hurdles appears to be almost impossible for foreign retailers during the initial stage of their foreign direct investment in China[23]. Nevertheless, *guanxi* is transferable and this characteristic of transferability allows foreign retailers to benefit from the *guanxi* network of their Chinese partners with political authorities. A Chinese partner

[22] According to Luo and Chen (1996 in Park and Luo, 2001), *guanxi* operates both horizontally and vertically. Horizontal *guanxi* is *guanxi* with other organisations in the task environment, such as suppliers, buyers, and competitors. Vertical *guanxi* is *guanxi* with various levels of government and regulatory authorities. In this section, vertical *guanxi* is the main focus.

[23] Foreign retailers also recognised that they themselves had to cultivate *guanxi* with government officials apart from utilising their partner's *guanxi* network at the initial stage of their foreign direct investments in China. The cultivation of relationships at different levels is discussed in a later section in the present chapter.

who possesses a well-cultivated *guanxi* network with legal and political authorities is a valuable if not essential resource for foreign retailers in China.

6.2.4 Equity Ownership of Foreign Partners

6.2.4.1 Research Results

The division of equity ownership of joint ventures between foreign retailers and Chinese partners is shown in Table 6.1. There was no information about the division of equity ownership for Companies B, E and J. Company H was a cooperative joint venture and therefore did not have the division of shares. Among the nine companies for which information was available, five foreign retailers had majority equity ownership and the other four foreign retailers owned between 40% and 49% of shares in the joint ventures.

Among the four companies who owned minority shares in their retail joint ventures, Company K and Company L were the only two retail joint ventures that, at the time of seeking entry to China, had strictly observed the rules of foreign direct investment promulgated by the Central government and had obtained the formal approval of the Central government in China. These two foreign retailers had had to agree to let their Chinese partners own at least 51% of shares in the joint ventures in order to obtain formal approval. At the end, both of them owned 49% of the shares in their respective joint ventures.

The other two companies that owned minority shares are Company G and Company M. Company G said that they would like to abide by the Central Government rules on majority equity ownership because they wanted to be a legal business enterprise in China. They did not want to encounter any potential political difficulty because of legality. This company also chose to own the maximum amount of shares that they were allowed to by Central Government regulations, normally 49%.

According to the Vice General Manger and the Beijing Office Representative of Company M, the founder of Company M had a strong sentimental attachment to China.

Assisting with development of the distribution system in China had always been the founder's wish. The founder met with the Prime Minister of China in the 1980s and promised that if China needed them, they would endeavour to help modernise the distribution system in China. Company M had maintained a very close relationship with the Ministry of Internal Trade since then. The origins of Company M imply that Company M had no intention of disregarding Chinese law on joint ventures when entering the market.

Companies A, C, D F and I were the five companies where the foreign partner owned majority equity in the joint venture. Company I was the last to enter the Chinese market among the interviewed retailers. Its first operation opened in July 1999, which was after the announcement of the *Experimental Measures On Commercial Foreign-invested Enterprises* in June 1999 that relaxed the restrictions on foreign equity ownership in retail joint ventures in China. Therefore, Company I managed to legally own a majority stake. The General Manger of Company I claimed that having a majority equity ownership was important because Company I wanted to have more control over the running of the business.

Companies A and F also believed that having control was important and therefore they also preferred to own as much equity in the ventures as possible. Normally, they preferred the form of a wholly-owned subsidiary in foreign direct investment. However, when they first entered China, foreign retailers were forbidden by the law to establish wholly-owned subsidiaries. Therefore, they had to adopt the form of a joint venture. Nevertheless, as they did not apply to the Central Government to establish their joint ventures in China but only got approval of local governments, these two companies managed to own majority shares in their joint ventures. Companies C and D also did not apply to the Central Government for formal approval for their retail joint ventures either. Their retail joint ventures were created with only the consent of local government who 'creatively bent the Beijing rules' and consequently, they managed to hold majority shares.

6.2.4.2 Discussion

The retailers in the present study did not have any choice on the mode of entry when they entered China. The Chinese law stipulated that the form of a joint venture had to be taken. As noted earlier, there were hardly any local food retailers that were of comparable scale or capability to foreign food retailers. Ignoring the legal requirement, it appears that the only benefit to be obtained for foreign retailers from joint ventures with local Chinese companies is to utilise the local companies' *guanxi* network with government officials and local suppliers and their knowledge of the legal and regulatory aspect of business practice in China. However, this contribution from the Chinese partner does not create long term sustainable competitive advantages for the joint ventures (Naughton, 1995 in Luo, Shenkar and Nyaw, 2001). From the data presented above, almost all of those interviewed preferred majority control (or as many shares as the law allowed) in their joint ventures. This preference, in turn, originates in the desire of firms to control their overseas business. Equity ownership forms the basis of acquiring effective control (Killing, 1982; Pan, 1996 in Pan and Li, 2000; Child and Faulkner, 1998).

6.2.4.3 Control

According to Pfeffer and Salancik (1978), the word 'control' in organisation theory involves the use of power, authority and other systems to monitor and influence the activities and outcomes of a firm's subunits and its member. In the context of international joint ventures, control refers to the process by which one business entity influences the behaviour and performance of another entity through the use of power, authority, and a wide range of bureaucratic, cultural, or informal mechanisms (Geringer and Hebert, 1989).

In a dynamic and unfamiliar environment of China, control is crucial to the evolution of a foreign-Sino joint venture. Control, however, is an intricate task because foreign and Chinese partners are very different in terms of culture, objectives and experience.

Insufficient or ineffective control will hamper the parent firms' ability to effectively coordinate activities, utilise resources and implement strategies (Geringer and Hebert, 1989). However, the need for control is not symmetric for both the foreign and the Chinese partners because foreign and Chinese partners are subjected to different cultural, economic and legal constraints. In the context of foreign food retailing in China, possessing managerial control, at both the strategic and operational levels, is especially important to the foreign partners for the following reasons.

First, there is a difference in objectives between the foreign and the Chinese partners. Foreign partners aim to obtain a competitive share of the Chinese market, whereas local partners focus on technological and organisational skills acquisition from their foreign partners. In order to obtain a competitive share of the Chinese market, a foreign retailer must be able to fully utilise its retailing expertise. In the context of food retailing, the retail concept and the retail operating system is the essence of a food retail firm. The product that a retailer produces is its retail stores[24]. A retail store can be perceived as the manifestation of a concept and a combination of different retail elements. The retail concept and the retail system are the fundamental constituents that give each food retailer its own distinct identity and competitive advantages. Naughton (1995 in Luo, Shenkar and Nyaw, 2001) points out that the superior technological and organisational skills contributed by the foreign parent are the main elements that determine the sustained competitive position of a joint venture in the Chinese market. If a foreign food retailer cannot put through their own concept and system in a host country, they not only suffer from dilution of and hence degradation in their brand equity[25] but they, more

[24] This is discussed in more detail in Chapter 7.

[25] Gomes-Casseres (1990 in Pan, 1996), Klein (1980 in Pan, 1996) and Klein and Leffler (1981 in Pan, 1996) claim that when a foreign partner commits an established brand to an equity joint venture located in a developing country, the foreign firms has more to lose and less to gain from diluting the brand equity than does the local partner. Therefore, there is a strong need for the foreign partner to have effective control over the venture to prevent its brand from degrading in the host country. In the context of food retailing, the brand concerned is a retailer's retail brand. Pan (1996), after conducting a study with 4223 international equity joint ventures in China from 1979 to the end of 1992, confirms that foreign firms with high brand equity prefer a higher equity ownership. His results also show that foreign firms with the following characteristics would prefer a higher equity ownership: strong capital, long equity joint venture contractual duration, high cultural distance between foreign and local partners, and when the joint venture

importantly, are not be able to produce the 'product' to leverage competitive advantages over their rivals and the kind of profits they expect. Therefore, foreign food retailers are keen to maintain effective control over their joint ventures in China so that they experience no barrier to the full exploitation of their retail expertise.

Secondly, control of an overseas joint venture also has important implications for a firm's global strategies. Possessing overall control of their joint ventures in China implies that the foreign parent is in position to control the strategic direction of the combined bundle of complementary resources represented by the joint venture (Geringer and Hebert, 1989) and therefore the foreign parent can implement their strategies and align the joint ventures in China with the overall strategies and long-term goals of the company at the global level, such as international supply strategies and global market expansion. This ability to develop the joint venture within the wider set of the company strategies on a global scale is especially important to foreign retailers compared to their Chinese partners, because a local firm in an emerging economy is unlikely to be in a position to integrate its main operations with those of the foreign-local joint venture (Luo, Shenkar and Nyaw, 2001).

For the Chinese parent, overall control may be neither desirable nor feasible. As pointed out earlier, Chinese firms and the Chinese government tend to use foreign-Sino joint ventures as a means to acquire foreign technologies and management know-how and to generate income. Subsequently, they are less concerned with the corporate strategies of the joint venture. Overall control is not primary for the Chinese parties to achieving their desired benefits. Furthermore, local businesses usually benefit from the Chinese government protection (Luo, Shenkar and Nyaw, 2001). The Chinese government has the ability to control market access to foreign firms and to hand out or withhold investment incentives. Such protection becomes even more apparent if the Chinese parent involves government ownership (Nee, 1992 in Luo, Shenkar and Nyaw, 2001).

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is located in either South China or the three metropolitan cities of Beijing, Shanghai and Tianjin. These characteristics appear to exist in the present cases of foreign retailers joint ventures in China.

This host government bargaining power and potential for institutional interference strengthens the position of the Chinese partner in monitoring and controlling the operations of their foreign-Sino joint ventures. The importance of overall control to the Chinese partner is thus further mitigated by the ability to manage political risk.

Thirdly, in order to implement their system effectively, some foreign food retailers believe that maintaining the parent's corporate culture is significant, and this also requires dominant control of foreign retailers on the running of their joint ventures. President of Company D claimed,

> "I think it is very confusing when you get your partner involved in the running of the business. You will just get a very confused culture in the company. To me, the company culture must be clear so that the staff will not be confused."[26]

6.2.4.4 Theoretical Implications

The present research results have demonstrated that the foreign retailers interviewed pursue maximum control of their business in order to ensure preservation of their retail systems and retail/corporate cultures. Therefore, the present research appears to show convergence to previous research in the sense that firms pursue majority equity ownership to safeguard their interests. However, the kind of interests foreign retailers try to safeguard is different to that explained in most of the existing literature, especially those studies that undertake the viewpoint of foreign manufacturers. Foreign manufacturing firms who operate in an unfamiliar environment of China usually rely on their equity stake to prevent potential opportunistic behaviour on the part of their local partners, which is often exercised in collusion with local authorities (Luo, Shenkar and Nyaw, 2001). On the contrary, foreign food retailers' desire to perpetuate their retail systems and corporate cultures in their overseas operations has little to do with guarding against opportunistic behaviour from their Chinese partners. Foreign retailers are mainly concerned about exploiting their retail expertise and ensuring that their joint ventures in China are developed in accordance with their strategies on the international level. This is important because, for example, developing an international network of supply is of strategic significance to an international retailer, especially when nowadays struggle for bargaining power between suppliers and retailers has escalated to an international level[27]. China is an important market in the world because of its sheer size and economic potential. If foreign retailers do not possess dominant control over their joint ventures in China, having operations in China may not give them a platform to increase their bargaining power over suppliers, both multinational and local. In other words, not possessing dominant control over their joint ventures in China may encumber the foreign retailers' international strategic development.

The stress by foreign food retailers on exploiting one's retail expertise to generate rent instead of on guarding against opportunistic behaviour illustrates that the FDI theory based on transaction cost is not appropriate in explaining equity ownership preference in FDI in food retailing in China.

6.2.4.5 Prerequisites for Negotiating Dominant Control

One must note that the retailers interviewed in the present study are mainly large retail groups and are internationalised to a certain extent. Large international firms are less likely to be affected by the cyclical changes in the risk condition in China and consequently, they are more likely to stay over a longer period of time (Pan and Li, 2000). Most of the retailers in the study mentioned that their foreign direct investments in China had a very long-term perspective. Moreover, large firms, compared to smaller firms, are more capable of raising the necessary resource to acquire a majority equity stake in their overseas joint ventures (Pan and Li, 2000). Large firms also possess the necessary bargaining power to acquire this equity position in the negotiation with the host country parties. This is especially true in the case of those foreign food retailers in China who entered with only the approval of local governments. As explained before, local governments in China are very keen to attract foreign investment and foreign

[26] Role of corporate culture is discussed in Chapter 7.
[27] This is discussed in Chapter 5.

technology into their domains in order to push forward the economic development. International food retailers with certain scale possess the expertise (such as supply chain management technology, retailing how-how and strong financial background) that is highly desired by local governments. Moreover, the number of local Chinese firms that possess strong financial resources that will enable them to acquire a majority ownership stake in a joint venture is very small. Therefore, the foreign food retailers in the present study were in a very strong position to negotiate majority equity ownership with both the local governments and local business parties. This may not be the case for smaller foreign food retailers.

6.2.5 Share of Managerial Control

In the last section, the importance of possessing the power to control their retail businesses in China to the foreign food retailers and the rationale behind the desire of such possession are demonstrated. This section focuses on the actual share of managerial control between foreign retailers and their Chinese partners and presents a more detailed discussion of dominant parent management.

6.2.5.1 Research Results

In the present study, eight retailers said that they had almost complete managerial control in the joint venture. Their Chinese partners were not involved in the daily operation and management of the business. What those foreign retailers needed to do was to report to their Chinese partners about the performance of the joint venture and hold board meetings with the Chinese board members. All of these eight foreign retailers claimed that they had good relationships with their Chinese partners and they had not experienced any major disagreement regarding either this arrangement on the share of managerial control or the daily operation and management of the business.

On the other hand, Company M mentioned that they managed and operated the business with their Chinese partners together. Company L said that they controlled the major managerial and operational issues in the joint venture but their Chinese partner controlled finance and personnel issues. Both Company M and Company L are from Japan. They reported no major conflict with their Chinese partners regarding the sharing of managerial control and the running of the business.

No information on the share of managerial control was obtained from the remaining three retailers.

6.2.5.2 Dominant Parent Management

According to Killing (1982), joint ventures in the industrial sectors of land development, construction, and oil and gas exploration are usually managed by one parent as if it were wholly owned subsidiaries and he calls these joint ventures 'dominant parent ventures'. The present study suggests that dominant parent management is also a common practice for foreign-Sino food retail joint ventures in China. The foreign-Sino food retail joint ventures in China that are studied in the present research are mainly managed by the foreign retailers. Although some functional managers were appointed by the Chinese parents, the number of such appointments remains very few. Moreover, although the board of directors are made up of members from both parents, the role that the board plays is mainly ceremonial because the ventures' operating and strategic decisions are usually made according to the foreign retailers' wishes. This situation is illustrated by the description of the Buying Manger of Company J,

> "Our partner does not really participate in the managerial control. But of course, they play a part as we have the responsibility to report to them. However, I will say it is a more a retailer run operation, meaning that we are the main party running this retail joint venture."

Killing (1982) demonstrates that dominant ventures usually outperform shared management ventures and the difference in failure rates between the two kinds is striking. The lower failure rate of dominant parent ventures indicates they are easier to operate than shared management ventures. With both parents sharing management, disagreements are easy to occur. When one parent dominates, disagreements will be largely reduced. However, there is a trade off between using shared management and dominant joint ventures. Dominant joint venture should only be used when the resulting disadvantages of having all partners running the business outweighs the resulting benefits.

According to Killing (1982), dominant parent management is appropriate under certain conditions. If one partner in the joint venture is chosen by the other partner for reasons other than management input, such as financial backing, access to resources, patents, or because it is an important consumer of the product to be produced by the joint venture, a dominant parent venture will be a fitting arrangement. Dominant parent joint ventures are also appropriate when one partner takes on another partner merely in response to pressures from a host government. In such a situation, foreign companies often prefer a passive local company that has no knowledge of the product, is willing to be a passive investor and is not government-affiliated. If the local partner never learns the joint venture's business, the dominant parent's bargaining position with the host government will remain strong. The passive partner will exert very little influence over the joint venture. Nevertheless, such arrangement will only work when the local partner trusts the competence and honesty of the dominant foreign company.

In the case of foreign retailing in China, the investing condition is similar to the condition under which dominant parent management should be adopted as suggested by Killing (1982). As mentioned before, foreign retailers entered China using the mode of joint venture because it was the only mode of foreign direct investment allowed in retailing. Foreign retailers took on their Chinese partners for their local networks and knowledge on local business practices. Most of the interviewed foreign retailers preferred to choose non-retailers as their Chinese partners so that their Chinese partners would be more willing to let them put through the their own retail systems. Under these circumstances, deducing from Killing's research, dominant parent management should be the most appropriate for such foreign-Sino food retail joint ventures. Coincidentally, most of the foreign food retailers interviewed did practise dominant parent management in China. Therefore, the present research extends the validity of Killing's finding onto the cases of international food retail joint ventures in China, which is a country with characteristics of a transitional economy.

Nevertheless, one point has to be noted, which is different from Killing's cases. All of the Chinese partners of the foreign food retailers interviewed were affiliated with the Chinese governments at different levels in some ways, as described in section 6.2.3. Under the legal and regulatory conditions on foreign food retailing in China, it is almost impossible to have a Chinese partner that is not affiliated with the government for two reasons. First, foreign food retailers must approach some Chinese local governments, if not the Central Government, in order to be approved to establish their operations in China. The Chinese government always tends to introduce or involve local business companies that are affiliated to them into the retail joint venture. Secondly, the foreign food retailers in the present study are of considerable scale and their investments in China are substantial. A potential Chinese partner must be financially able to take up a reasonable amount of equity or even majority equity (as stipulated by Chinese law in the past) in the foreign-Sino retail joint venture. Unfortunately, due to the legacy of communism, all businesses were state-owned in the past. Therefore, there is, at the moment, hardly any local company that is financially strong enough to be a partner in such a foreign-Sino retail joint venture that is not under the influence of the government.

6.2.5.3 Relationships Between Foreign and Local Partners

The present research found that most foreign retailers had good relationship with their Chinese partners. Five retailers interviewed (Companies A, J, E, G, and I) did not comment on their relationship with their Chinese partners. Seven foreign retailers reported that they were happy with the co-operation and distribution of managerial control with their Chinese partners. The Chief Food Purchasing Officer of Company F expressed,

> "We have very good co-operation with our partner. They are actually participating in management, although we have the major control. My colleague, who is from the Chinese side, is not some useless guy in the back office trying to

> control everything. He is actually an active member of the management in the sense that he is open-minded and is willing to listen and learn. He is up to the job. Our Chinese partner as a whole is also open minded and willing to listen to us and learn."

The Chief Non-Food Purchasing Officer of Company F also had a similar appreciative experience with their colleagues from the Chinese side,

> "Although our company is pretty much in the managerial control of this joint venture, we have Mr X from the Chinese partner. He is in charge of the sales of stores. He fully represents and gets full support from the Chinese partner. Mr X and I discuss important or critically issues jointly. So far, I think our foreign side has a very good relationship with the Chinese partner. Moreover, I believe our joint venture is one of the best joint ventures in China at the moment in terms of co-operation and relationship between foreign and local partners. Our joint venture is also very successful in terms of operational performance so far."

Only one company from the thirteen retailers interviewed, Company D, claimed that they were not too satisfied with the performance of their Chinese partner because their Chinese partner was unable to obtain more business licenses for the joint venture at the rate they wanted.

All these eight retailers said that they had experienced no major conflicts with their Chinese partner. They admitted that sometimes there was disagreement but they normally could reach consent at the end. The Chief Non-Food Purchasing Officer of Company F remarked,

> "We have had quite intense discussion but we ended the discussion with common objectives."

Company M had also experienced objection from their Chinese partner to enlargement of their scale of operation in China because their Chinese partner held a different perspective on fresh food buying behaviour of Chinese people[28]. Nevertheless, they successfully persuaded their Chinese partner to agree with their plan in the end.

[28] This is discussed in detail in section 7.3.

Furthermore, minor conflict is regarded as healthy for the business by the General Manger of Company K as he pointed out, "our Chinese partner is very critical, but it helps to improve our operations."

Conflicts between foreign and Chinese partners are always claimed as an important factor leading to the failure of joint ventures in China. Having a good relationship with their Chinese partner is therefore very important to the foreign retailers. No major conflict was reported in the present research. It appears that the combination of adopting dominant parent management and having a Chinese partner who is not in the food retail industry works well for the foreign-Sino food retail joint ventures in China. Another important reason for the harmonious co-operation between foreign and Chinese partner is that the major objective of the Chinese partners is to learn the retailing expertise and management know-how from their foreign counterparts. Because of this intention, the Chinese partners are more willing to listen instead of to control. Consequently, the number of conflicts is limited and the joint venture can be run more smoothly.

This situation may not be sustained for long because as time goes, both the Chinese side and the foreign side shall be able to acquire a considerable amount of knowledge they need. When the Chinese side is more knowledgeable, it may want more control. Simultaneously, the foreign retailers, as they develop, will be able to accumulate knowledge about the Chinese retail environment. Furthermore, as mentioned before, foreign retailers will be able to operate as wholly-owned subsidiaries in China in a few years time. As some interviewees expressed that they normally prefer the form of wholly-owned subsidiaries to joint venture when they undertake FDI, there is a possibility that foreign retailers will separate from their Chinese partners once the restriction is removed in the near future.

6.3 Site Selection

This section investigates five issues relating to site selection and store development process of foreign food retailers in China. First, there is a comparison of retail environment of Beijing, Shanghai, Guangdong and Shenzhen in terms of economic development, landscape of retail industry and political condition. The factors that affect the city selection decision of foreign food retailers are also discussed here. Secondly, criteria for choosing a store site are examined. The third issue is the availability of suitable sites from the point of view of foreign food retailers. Fourthly, the legal procedure and technical issues related to developing a site and a store are looked at. The last issue is about political opposition from local retailers against the development of foreign food retailers in China. The reader should note that a detail investigation of land trading and property development in China is outside the scope of the present study.

6.3.1 Comparison of Retail Environment of Different Major Cities in China

In China, the spatial distribution of population is unbalanced, with concentrations in coastal provinces. Together with historical circumstances and physical geographic conditions, the economic policy of the introduction of Special Economic Zones (SEZs): Shenzhen, Zhuhai, Shantou, Xiamen and Hainan; Open Coastal Cities, including Shanghai; Open Coastal Economic Areas; Pudong New Area, which were established in 1990; and Free Trade Zones further enhances the uneven development among different places in China. Such imbalance is a key feature of the economic geography of China and that with the introduction of economic reforms, these imbalances have surfaced as a central issue in China. Poverty levels and trends vary greatly between rural and urban areas, and between different regions of the country. By employing the World Bank's poverty line of $1 per person per day and the 1985 purchasing power parity, it is estimated that 13.5 percent of the population is poor (Woo, Parker and Sachs, 1997). Moreover, different areas in China offer different investment incentives to attract foreign direct investment. A study by Hongkong Bank (1993 in Davies, 1993a) reveals that in

1993 decentralisation of economic autonomy to enterprises and regions has exceeded the extent of that in 1988. Consequently, tensions between Central State Council and the provincial and large municipal governments over the form of the legislation governing foreign companies and the pace at which it should be implemented have resulted. Competition for investment and funds among regions also arise. All of these issues play a part in the consideration on locational choices of foreign retailers who are wishing to invest in China. Therefore, foreign investors should not treat China, with its 1.2 billion population, as one huge homogeneous market.

In fact, when the activities of foreign food retailers are examined, it is found that Beijing, Shanghai, Guangzhou and Shenzhen, are the four most popular locations chosen when they first set foot on China. The overall environment for foreign retail investment in these four places is broken down into three elements: economic development, retail industry development and political condition. These three elements are discussed individually below in terms of statistical assessment and retailers' own evaluation before a summary of the overall picture of these four places is given.

6.3.1.1 Economic Landscape: An Overview

Statistical information on certain aspects of the Beijing, Shanghai and Guangdong (which includes Guangzhou and Shenzhen) are shown in the following table. Data is extracted from *Statistical Survey of China* by the Chinese National Bureau of Statistics. Shenzhen is a special economic zone but is not a province and therefore there is no data about Shenzhen on its own is available from the Statistics Bureau. However, Shenzhen is part of Guangdong. Therefore, statistical information about Guangdong incorporates that about Shenzhen.

Table 6.2 Statistical Information on Selected Aspects of Beijing, Shanghai and Guangdong, Year 1998

Province	GDP (Hundred Million RMB/Hundred Million US$)		Population (Ten Thousand)		Average Disposable Income per Person in Urban Area (RMB/US$)		Total Sales in Wholesales and Retail Sector (Hundred Million RMB/Hundred Million US$)[1]	
		Rank*		Rank*		Rank*		Rank*
Whole PRC	79552.8/ 9584.7		124810		5425.1/ 653.6		19185.8/ 2311.5	
Beijing	2009.9/ 242.2	16th	1246	26th	8472.0/ 1020.7	3rd	758.7/ 91.4	11th
Shanghai	3688.2/ 444.4	9th	1464	25th	8773.1/ 1057.0	2nd	1189.8/ 143.3	5th
Guangdong	7937.2/ 956.3	1st	7143	5th	8839.7/ 1065.0	1st	2141.3/ 258.0	1st

(con't)	Total Foreign Direct Investment (Actually Utilised) (Ten Thousand US$)	
		Rank*
Whole PRC	4525704	
Beijing	159286	8th
Shanghai	422536	3rd
Guangdong	1171083	1st

Source: Chinese National Bureau of Statistics, 1999a, *A Statistical Survey of China*. Chinese Statistical Publishing.

[1] The author was unable to obtain figures for retail sales alone.

*Rank among all the 31 provinces in Mainland China

Note: Regionalised statistical information is gathered on the provincial basis. In China, there are 31 provinces: Beijing, Tianjiang, Hebei, Shanxi, Inner Mongolia, Liaoling, Jilin, Heilongjiang, Shanghai, Jinagsu, jijinag, Anhui, Fujian, Jiangxi, Shandong, Henan, Hubei, Hunan, Guangdong, Guangxi, Hainan, Chongqin, Sichuan, Gueizhou, Yuannan, Tibet, Xianxi, Ganshou, Qinghai, Lingxia and Xinjiang.

As shown in table 6.2, Guangdong, Shanghai and Beijing are the three provinces with the top urban average disposable income in China. Furthermore, Guangdong is ranked the first in terms of GDP, urban average disposable income, total sales in wholesale and retail sector and actually utilised foreign direct investment. Combining the statistical information on the aspects shown in the table, retailers' decisions of choosing one of these three places to launch their entries in China appear to be logical.

The author's interview with the thirteen retailers offers further insights of the perception of foreign food retailers on the economic conditions of Beijing, Shanghai, Guangdong and Shenzhen. Apparently, they all looked at Beijing, Shanghai, Guangdon and Shenzhen as the most economically advanced places in China and are the most suitable for modernised retail development. In particular, they expressed that Shanghai is the most commercialised in China and has a very high income level. There is no denying that different foreign retailers put different amount of focus on different cities when they evaluated the various cities during interview. This is because their perception on economic situation of a city, and preference of a certain city, was influenced by their perception on other aspects of the city, such as competition landscape and political condition. All the three aspects of economic situation, competition landscape and political condition have to be considered together in evaluating the environment of different cities for foreign retail investment. Competition landscape and political conditions will be discussed in the following sections.

Table 6.3 Summary: Perception of Foreign Food Retailers on the Economic Conditions of Beijing, Shanghai, Guangdong and Shenzhen

Company A	• Guangdong has about 70 million population. • Guangdong is close to Hong Kong. • Development is most influenced and closest to Hong Kong compared to other places in China.
Company B	
Company C	
Company D	• Guangzhou has considerable opportunities. • People in Guangzhou are more mobile and Westernised. • Guangzhou is a very commercial city and more developed compared to other places in China.
Company E	• Shanghai is very commercial. • Consumer awareness in terms of what they buy and who they buy from: Shanghai>Guangzhou>Shenzhen> • Beijing
Company F	• Disposable income in Shanghai is very high. • Shanghai is the business centre of China, easily accessible from different direction and from different countries, and has relatively good infrastructure compared to other cities in China. • Shanghai is the largest market for FMCG retail in China. • Food consumption in Shanghai is about 5% of that of whole China, even though there is only about 14 million inhabitants here.
Company G	• Shanghai is very commercial
Company H	• Shanghai is very commercial, technological advanced compared to other places in China.
Company I	• Beijing is about 10% to 25% less populated than Shanghai, but disposable income in Beijing is only about 5% less than that in Shanghai. However, there is less number of FMCG stores in Beijing than in Shanghai.
Company J	
Company K	
Company L	
Company M	

6.3.1.2 Landscape of Retail Industry: An Overview

In 1996, there was a total of 2785 foreign funded retail outlets in China (Glasse, 1999). The number jumped from 393 and 518 in 1994 and 1995 respectively to 2785 in 1996. Unfortunately, there does not exist any officially published data on the total number of outlets of foreign funded food retail outlets. Major foreign food retailers in China are listed in Table 6.4.

From the author's observation, there are many different kinds of food retail outlets. These include 'mom-and-pop' stores, kiosks, traditional Chinese wet markets, supermarkets, cash-and-carry, hypermarkets, supercentres, warehouse clubs, independent grocers and food stores, and convenient stores. In the supermarket sector, there are a few local retailers in Shanghai that are very strong compared to foreign retailers with the same format. These are Lianhua, Hualian, and Nonggongshang (Table 6.5). The number of outlets of Lianhua and Hualian together in Shanghai increased to more than 400 in 1999[29]. Even Royal Ahold could only occupied the 24th position after 21 indigenous and two Hong Kong supermarket retailers in 1996 (Glasse, 1999). Late 1999/early 2000 saw the disinvestment of Royal Ahold from China and it is widely believed that it was due to their poor performance in financial terms in Shanghai[30].

Table 6.4 Foreign Food Retailers Active in China

Foreign Food retailer	Country of Origin	Year of First Entry	Retail Format(s)	Present In year 2000?
Auchan	France	2000		Y
Carrefour	France	1994	Hypermarket	Y
Continent (Promodès)	France	1999	Hypermarket	Y
CRC	Hong Kong	1992	Supermarket	Y
Daiei	Japan		Convenience Store	
IGA (PRD) [a]	Hong Kong	1997	Supercentre	Y
Ito-Yokado	Japan		GMS [c]	Y
Jusco	Japan	1995	DS with supermarket [d]	Y
Lotus	Thailand	1997	Supercentre	Y
Makro	Netherlands	1992	Cash and Carry	Y
Metro	Germany	1996	Cash and Carry	Y
Park'n Shop	Hong Kong	1988	Supermarket	Y
President Enterprises	Taiwan			
Royal Ahold	Netherlands	1996	Supermarket	N [e]
RT-Mart	Taiwan	1997	Warehouse Club	Y
Seiyu	Japan	1995	DS with supermarket	Y
Seven Eleven	Hong Kong	1992	Convenient Store	Y
Wal-Mart	USA	1995	Supercentre and Warehouse Club	Y
Wellcome	Hong Kong	1994 [b]	Supermarket	Y

[29] Source: Author's field study
[30] Source: author's field study. The author has attempted to contact Ahold to confirm the reasons behind their closure but without success.

Remarks:
[a] PRD stands for Pearl River Distribution. It is a company from Hong Kong and they bought the franchise of IGA, which is from USA, and operate in China.

[b] Wellcome started managing supermarkets in Beijing inside 2 hotels back in 1989. However, their actual investment in China started in 1994 in Shenzhen.

[c] GMS stands for General Merchandise Store. It is, basically, similar to a department store with a supermarket at the lowest level. This is a term used by Jusco to describe its own format.

[d] D S is an abbreviation for Department Store

[e] When the author was conducting her fieldwork in Shanghai in the summer of 1999, Ahold was undergoing restructuring. When the author attempted to contact them again in winter 1999/Spring 2000, it was found that they had closed their operations in China.

Sources:
Company interviews;
The Asian Wall Street Journal (issues published between June 1991 and November 1997);
The China-Britain Trade Review (issues published between July 1993 and February 1998);
The Economist (issues published between January 1991 and September 1997);
Davies, K. 1993a. "The Lure of One Billion New Customers: Foreign Investment in the Retail Sector of the People's Republic of China". Working Paper 9301, Institute for Retail Studies, University of Stirling;
Glasse, J. 1999. *Supply Chain Management in China: Pitfalls and Opportunities to 2005.* London: Financial Times.

Overall, small retailers continue to predominate in the China retail market (Glasse, 1999). Moreover, around 70% to 80% of fresh food items are purchased from the traditional Chinese wet markets (Glasse, 1999). These wet markets are an essential part of Chinese people's life because freshness is much emphasised in Chinese 'eating culture'. A lot of the bigger scale foreign food retailers had incorporated the wet market into their stores to attract customers to enter the stores to induce their buying. Despite the aggregate dominance of small retailers and the wet markets, warehouse club, supermarkets, hypermarket and cash-and-carry have proved to be popular and food retailing has experienced the fastest growth within the retail sector in China (Glasse, 1999). It is further forecast that the number of such outlets will grow and these retail formats will prosper.

Table 6.5 Leading supermarket chains in China, 1996

Rank	Name	Number of Shops	Turnover (RMB, million)	Turnover (US$, million)
1	Shanghai Lianhua	101	900.0	108.4
2	Shanghai Hualian	108	800.1	96.4
3	Hutchison Whampoa/ Shenzhen Park'n Shop/ Shanghai Park'n Shop	42/27/15	520.2/299.1/221.2	62.7/36.0/26.7
4	Shenzhen Huarun	44	327.4	39.4
5	Shenzhen China Resources	43	324.9	39.1
6	Shanghai Nonggongshang	38	248.6	30.0
7	Zhengzhou Huaqiao	31	200.0	24.1
8	Shanghai Zhonghui	15	170.4	20.5
9	Dongguan Meijia	40	145.9	17.6
10	Shanghai Jieqiang	30	134.4	16.2
11	Beijing Wufu	22	132.9	16.0
12	Beijing Mingzhu	15	132	15.9
13	Wuxi Yong'an	25	132	15.9
14	Beijing Xifu	32	111.9	13.5
15	Dalian Wangda	28	110.3	13.3
16	Hainan Shida	10	110	13.3
17	Beijing Dakelong	16	110	13.3
18	Shanghai Huishan	19	109.4	13.2
19	Qingdao Haibin	10	103.2	12.4
20	Beijing Fanxing (Xidan Store)	30	102	12.3
21	Guangzhou Your Ground	14	73.3	8.8
22	Foshan Baihui	15	52.5	6.3
23	Guangzhou Grandcity	13	50.0	6.0
24	Royal Ahold	15	25	3.0

Source: Taken from Glasse (1999, p.27)

Based on the author's interviews, Table 6.6 provides a summary of how foreign food retailers perceived the competitive situation in Beijing, Shanghai, Guangzhou and Shenzhen. Basically, most foreign retailers did perceive that retail competition in Shanghai is the keenest in China. Guangzhou and Shenzhen have a similar degree of competition too. Consequently, margins have become so thin because of cut-throat pricing. Subsequently, surviving in the retail market in those places, especially Shanghai has become very difficult. There is less competition among retailers in Beijing and therefore there is relatively more room for foreign retailers to manoeuvre. The Chief Non-food Purchasing Officer of Company F pointed out,

> "As a matter of fact, the retail market in Shanghai is the most competitive in China and then Beijing and Shenzhen. Of course the retail market in Shanghai is also the largest in comparison to others. I believe there is still room for retailers in Shanghai, but not a lot of room, because the market is just that big. Another one comes in is going to kill somebody else, or everybody else is going to suffer a little bit. Right now, we are not in a situation where demand can be created by supply. If there is oversupply, everyone suffers. You can see the same thing happening in Eastern Europe after the crashing in of everybody (meaning retailers). Say Poland, by the end of April, all the British were there, all the French were there and all the German were there and the situation and competition is crazy. At the moment, the situation in Beijing and Guangzhou is not as bad as Shanghai although it is getting close"

The Director, China Development of Company A showed a similar concerned,

> "The increase in the number of supermaket outlets is very quick but it doesn't mean that there is no room for foreign retailers. Of course this makes it tougher for every player. The number of stores of Hualian and Lianhua (two leading local supermarket chain) together in Shanghai is more than that of Wellcome and Park'n Shop together in Hong Kong. Of course in terms of volume per store, they may be lower than that in Hong Kong, but in terms of outlet and trading area, they are proceeding very quickly. Of course I suspect that their speedy development is mainly because of governmental support and backing."

The same view is shared by the Buying Manager of Company J. He further claimed that the margin has become increasingly low and competition is highly price-oriented,

> "Shanghai is over run with local supermarket chains: Hualian, Lianhua and Nonggongshang. In between them they have something like 500 stores. This is a huge number. Furthermore, one must note that these strong local competitors are getting preferential treatment in their development...... Margins are not what they are in the UK. Tesco gets about 30% average margin. It is not the case in China. Also, in the last two years, there was food deflation. The prices of food in supermarkets are generally coming down. Like now, Pepsi in BJ is about 1.8 RMB. Two years ago, it was about 2.2RMB. It is quite a big difference. Retail prices are being pushed down a lot more. So, every player is struggling to increase sales against general deflation in the market and against the decrease of consumers' willingness to spend money over the last few years. Consumers are

getting more money but they are less willing to spend. For example, in Shanghai, the market share of some of the more expensive leading manufacturing brands are being taken away by the cheaper options of the same product. For retailers, the margin for supermarkets in both Shanghai and Beijing is tiny, maybe about 5%. If you don't take the price down, the store next to you will give a 10% cheaper price. What are you going to do? Basically supermarkets attract people on the basis of low prices. It a very price-oriented. Of course any retailer around the world is price-oriented but the price-orientation in Shanghai and Beijing is more serious. Shanghai is more price-oriented than Beijing, because of more competition in Shanghai. In Shanghai, if a consumer does not want to buy here, he can easily find another one within a very very close distance. In Beijing, it's not quite the same, it's a big city. If he doesn't buy here, he probably needs to travel half a kilometer to find another store. So, it's a bit different. Moreover, consumers in Beijing are a bit less conscious about how much they spend compared to those in Shanghai. People in Beijing tend to spend more money than Shanghai."

The Executive Director, Finance of Company E also pointed out that every retailer in Shanghai competes by cut throat pricing at the moment. Subsequently, a lot of food retailers in the Shanghai market hardly make any money. The General Manager of a partnering company of Company L made the same comment about the low retail margin in Shanghai.

On the other hand, the Executive Director, Finance of Company E revealed some problems of the Guangzhou market, albeit the competition there is not as intense as in Shanghai. One main problem in this market is counterfeit goods. He observed that consumers habit in Guangzhou is different from that in Shanghai. He also saw that the development of the retail market in Guangzhou is not well-planned and is quite chaotic. Nevertheless, he said that food retailers in general can still make money so far.

For the Shenzhen retail market, the Director of Company A held this view,

> "Competition among food retailers in Shenzhen is getting more intense too, because there are already quite many local and foreign food retail operations there. On the other hand, it is not a big market but the income level there is the highest in China."

Table 6.6 Summary: Perception of Foreign Food Retailers of the Competitive Situation in Beijing, Shanghai, Guangdong and Shenzhen

Company A	• Competition was not a critical factor to Company A about four or five years ago, but it is now. • Shenzhen is not that big a city, but income level here is high. However, competition is very keen too. We may need to think about starting consolidation. • Shanghai is similar to Shenzhen in terms of income level and competition. However, the qualitative aspect of competition is different. Shanghai government has a more long-term orientation and better plan on developing retailing industry. Therefore the three top Shanghai local retailers have been developed so quickly with the Shanghai government's backing.
Company B	
Company C	• Competition in Shanghai is the keenest. Guangzhou is better for Company C.
Company D	
Company E	• Intensity of competition is ranked in this order by Company E: Shanghai>Guangzhou>Shenzhen>Beijing • Cut-throat pricing in Shanghai. The retail pricing in Guangzhou is similar. The competition in Shenzhen and Shenzhen outskirt is less keen relatively and therefore there is less price war.
Company F	• Competition in Shanghai is obviously more intense than that in Beijing and Guangzhou because most people sees Shanghai as the centre of industry and commerce and therefore lots of foreign retailers coming in.
Company G	
Company H	
Company I	• The total number of FMCG outlets in Beijing is much less than in Shanghai. Therefore, there is less competition in Beijing.
Company J	• There are too many supermarkets in Shanghai, especially the local ones. The local supermarket chains get preferential treatment from the government. • Competition in Shanghai is more price-oriented than in BJ. • There are many supermarket outlets in Guangzhou too. Consolidation may occur there soon.
Company K	•
Company L	• Competition in Shanghai is very keen. There is less competition in Beijing. • Retail margin is very low in Shanghai.
Company M	• Competition in all Beijing city, Shanghai city and Guangzhou is very keen. • Almost reaching saturation.

The data from both the secondary sources presented earlier and the author's interviews with foreign food retailers in China indicate three points. First, there is very intense competition in Shanghai. Secondly, the situation in Guangzhou and Shenzhen is developing close to that in Shanghai. Thirdly, food retail competition appears to be the least when compared to Shanghai, Guangzhou and Beijing. The next section will investigate the political conditions in these four places.

6.3.1.3 Political Conditions: An Overview

The legal and regulatory environment for foreign food retail investment has been discussed at the beginning of this chapter. This section, therefore, concentrates on how foreign retailers evaluated the political conditions of different cities in China. According to the author's interview results, Shanghai, in general, is believed to be the most suitable for foreign retail development politically, because Shanghai government appears to be more open-minded and have a long term vision of supporting the development of distribution and retail industry in the province. They are keen on introducing advanced retail management system and know-how from foreign food retailers. The Chief Operating Officer of Company F put it this way,

> "All government officials in Shanghai are very open-minded, very well trained about dealing with commerce, and have seen a lot of the world. Therefore, they have very different view to some of the administrative people in Beijing."

Beijing is thought to be a more political place in which commercial activities do not receive first priority. The Chief Non-Food Purchasing Officer of Company F said,

> "Beijing is a place with lots of politics. Relationships networking rather than economic results that matters. In Shanghai, your business performance plays a bigger role in determining the government's attitude towards you. This is the main difference in terms of political conditions between Beijing and Shanghai."

The General Manager of a foreign partner of Company L also remarked that, "I think Beijing is a place for politics, not for commerce." Guangdong and Shenzhen, on the other hand, are viewed as places where the governments have relatively little support or interference on the development of both local and foreign food retailing in their domains. The following is a table summarising the views of the foreign retailers that the author interviewed on the political conditions of Beijing, Shanghai, Guangdong and Shenzhen.

Table 6.7 Summary of Perceptions of Foreign Retailers on Political Conditions in Beijing, Shanghai, Guangzhou and Shenzhen

Company A	
Company B	
Company C	
Company D	• Beijing is the capital and it is a very political place.
Company E	• In terms of government support towards foreign food retailing: Shanghai>Shenzhen>Guangzhou>Beijing • Guangzhou government does not have any plan on the retail development in Guangzhou.
Company F	• Shanghai government officials are well trained and open-minded. • The further away physically from the Central Government, the more freedom foreign retailers have in developing their business. • The are a lot of politics in Beijing. Relationship instead of economic performance that counts. This is the main difference between Beijing and Shanghai.
Company G	
Company H	
Company I	
Company J	
Company K	• Strict foreign retail regulation in Beijing.
Company L	
Company M	

The following section combines the elements of economic development, retailing industry development and political conditions to derive the overall picture of the environment that embraces foreign direct investment in retailing in China in Beijing, Shanghai, Guangzhou and Shenzhen.

6.3.1.4 Summary: Overall Environment for Foreign Direct Investment in Retailing

Beijing is the capital of China and is considered the second largest shopping centre in China. The municipality is under direct administration of China's Central Government. There are 10.6 million permanent residents in the city, while the transient population is over 3 million. Its overall economic power is next only to Shanghai. In 1998, the GDP of Beijing reached RMB 201 billion (which is US$ 24.2 billion). On the other hand, the municipality is also granted the privilege to enjoy all the preferential policies given to open coastal cities. Owing to the fact that the city is administrated directly by China's Central Government, all the projects involving foreign direct investment have to go through the Central Government as well and therefore they will be subjected to more prudent scrutiny and stricter compliance to the regulations regarding foreign direct investment.

Shanghai, on the other hand, with a population of 14 million in 1998, a GDP of RMB 368 billion (US$ 44.3 billion) and per-capita disposable income of RMB 8773.1 (US$ 1057), has enjoyed the status of the best-known industrial city in China since the 1930s. In 1930s and 1940s, it was also a very important financial and trading centre on the Western Pacific coast. It was the most prosperous commercial city in China. However, after 1949, its overseas connections were truncated for many years due to China's self-imposed isolation. Nevertheless, Shanghai nowadays is still famous for being China's most active retail centre. It has played the role of the largest shopping centre in China since the beginning of the twentieth century (Mun, 1988). Moreover, with the economic reforms and open door policy after 1979, Shanghai has strengthened its relationship with the rest of the world again. According to a study by Nyaw (1996), the majority of the foreign investors in the city perceive it as a place with huge market potential in China. They also believe that Shanghai offers them workers at a lower rate level but with higher technical skills, higher technological capabilities and short payback period of investment. On the other hand, as provincial government has been granted autonomy to a certain degree to deal with approval of projects related to foreign direct investment, in order to strive to maintain its reputation of good quality, the provincial government will adopt a more welcoming and open attitude towards foreign direct investors.

Guangzhou and Shenzhen, on the other hand, have a very high geographical proximity to Hong Kong. They have been largely subjected to the influence of Hong Kong's life style. The products offered in these two locations tend to imitate the design of those in Hong Kong. In 1998, Guangdong has a population of 71 million. Its GDP amounted to RMB 794 billion (US$ 95.7) in 1998, with a per-capita income of RMB 8840 (US$ 1065.1). Its location is quite distant from Beijing, where the Central Government is situated. This, together with the proximity with Hong Kong, Guangzhou and Shenzhen also adopt a more open attitude towards foreign investment. In fact, it has always attracted the largest proportion of foreign direct investment in China (Table 6.8).

Table 6.8 Shares of Foreign Direct Investment in the PRC by Region, 1979-1993, 1998

Year	Guangdong %	SEZs %	Shanghai %	Beijing %	China (US$ million)
1979-1989	42.2	20.5	8.1	9.8	15 495
1990	45.0	20.2	5.5	8.5	3 487
1991	44.9	23.9	4.1	7.0	4 366
1992	31.6	10.8	7.0	3.1	11 007
1993	28.7	9.8	8.9	2.6	27 515
1998	25.9	-	9.3	3.5	45 257

Sources:

Figures for 1979-1993: Adapted from Nyaw, M. K. 1996. "Investment Environment: Perceptions of Overseas Investors of Foreign-Funded Industrial Firms" in Y. M. Yeung and Y. W. Sang (eds.) *Shanghai: Transformation and Modernisation Under China's Open Policy.* Hong Kong: The Chinese University Press.

Figures for 1998: Derived from China National Bureau of Statistics, 1999a, *A Statistical Survey of China.* Chinese Statistical Publishing.

The implication of the different environments that embrace foreign direct investment in retailing in Beijing, Shanghai, Guangdong and Shenzhen respectively is different for different foreign food retailers in terms of selecting an appropriate city. This is because the strength of retailers varies and each retailer has its own emphasis on different factors when they evaluate the overall suitability of a place for their foreign direct investments[31]. Consequently, retailers' choices on the first city to enter differ. Nevertheless, there is a common implication of diverse environment in different cities for all foreign retailers in China. This is regional protectionism[32]. Regional protectionism in China is a common phenomenon that impedes the pace of distribution reform. An unequal pace of economic development across regions and wide variations in

[31] The factors that foreign food retailers used in determining which city of China to entry first is discussed in the next section.
[32] Regional protectionism is discussed in more details in Chapter 8.

reform policy are hence inevitable. Moreover, regional protectionism may also result in a lack of lateral co-operation that in turns makes co-ordination of distribution activities in different provinces an extremely difficult task. This issue will be investigated in further details in a later chapter.

The next section looks at the elements foreign food retailers considered when determining the city to launch their first operation in China.

6.3.1.5 Factors Affecting the Selection of City

For food retailing, the usual factors that would be considered in deciding whether a market is suitable or not for a retailer to set foot on include GDP, population, income level, consumer buying habits and life style and competition. As mentioned in an earlier chapter, foreign food retailers were attracted to China for its market potential based on its huge size of population and the rate of economic development. Foreign retailers were, by law, only permitted to invest in Beijing, Shanghai, Tianjin, Tsingtao, Guangzhou and Dalian; and the five Special Economic Zones (SEZs): Shenzhen, Zhuhai, Shantou, Xiamen and Hainan when the retailing sector was first open to foreign direct investment. Guangdong, which include Guangdong and Shenzhen, Shanghai and Beijing show the highest disposable income level among all cities in China. Therefore, these three places have become the logical choices for foreign food retailers to launch their first operations in China. Different retailers have different ways to evaluate the overall appropriateness of a place for their own foreign direct investment although they are given the same set of economic indicators. This is because in assessing which place is the most suitable for them, they also need to consider their own company resources. Therefore, different retailers look at competition in the same place differently. The relationship or *guanxi* network that one retailer has also differs in different places. The remark of the President of Company D illustrates this point very well,

> "We have a local partner and an international partner in our joint venture here. Our international partner have got a considerable amount of influence in this province. They have got many other businesses here. So in this joint venture,

they are one of the partners. This is one of the important factors we considered in choosing this city."

The location of foreign retailers' potential Chinese partners also plays a crucial role in their choice of city because as pointed out before, suitable Chinese partner for foreign-Sino food retail joint ventures is not numerous in China. The following table provides a summary on the factors that foreign food retailers considered in choosing their first city of entry in China after they compared the retail environment of Beijing, Shanghai, Guangzhou and Shenzhen in terms of political condition, economic situation and retail competition in general.

Table 6.9 Summary of Factors that Foreign Food Retailers Considered in City Selection in China

Company A	• Economy, consumer buying habit and life style, connection that Company A has and the location of potential partner.
Company B	
Company C	
Company D	• 50 different locations in China were identified and each of those location was considered in terms of GDP, Population, retail expenses, legal problem to establish a retail business.
Company E	• Company's familiarity with the market.
Company F	• The location of potential partner.
Company G	• The location of potential partner and development of economy and commerce.
Company H	• Development of commerce and infrastructure.
Company I	• Development of commerce and competition.
Company J	• Physical proximity to country of origin (ease of control and familiarity with the market) and industrial growth.
Company K	• Where they got the business licence.
Company L	• Where they got the business licence.
Company M	• Market potential and the location of potential partner.

The economic development in China is gathering further momentum. The economic indicators of the inner cities in China are improving. This, coupled with the lack of competition in those inner cities, triggers the extension of interest of foreign food retailers into cities west of those coastal Chinese cities. Nevertheless, political factor appears to remain significant in foreign food retailers' decision on what cities to expand into.

> "I did a review of the whole of China. We looked at the potential of different parts of China. We identified 50 locations. We then group them up in sectors. Now I am running the southern sector and a colleague of mine is running the northern sector. We got those cities well documented, in terms of GDP, population and retail expense. Since I have been here, I have travelled quite extensively. Even last week, I was in Kumming and Chongqing. This morning, we have people from Cheungsha talking about a business opportunity in Cheungsha. So there are adequate opportunities all over here. But we have to solve the legal problem. So, we are ready to move very quickly once we get this thing behind us," said the President of Company D.

As presented at the beginning of this chapter, China is progressively liberalising its policy on foreign direct investment in retailing as a result of gaining entry into the World Trade Organisation. Foreign food retailers should gradually have more freedom in expanding into cities of which the income level and other economic indicators are becoming appropriate for modern retailing.

6.3.2 Criteria for Choosing a Store Site

Store location decisions have always been of critical importance to the success of retailers (Achabal, Gorr, and Mahahan, 1982 in Kaufmann, Donthu and Brooks, 2000). There is no shortage of literature and research on this subject. A number of disciplines have been contributing to the development of this topic. According to Clarke, Bennison and Pal (1997), the traditions of research on retail location can be classified into two main categories: the geographical tradition and the management/marketing tradition.

The geographical tradition can be further divided into three different inter-related strands. The first strand concerns the spatial patterns of retailing. At the macro-level, this research strand looks at the distribution of shops, shopping centres and retailers within an area, and the associated patterns of shoppers' behaviour. At the micro-level, the internal arrangement of shops within centres and its relationship to shoppers' movements are studied.

The second strand lies in the development of data and techniques for locational analysis and evaluation. This strand of research complements and build on those data and techniques derived from the practitioner school of retail location, which is largely presented by the work of Nelson (1958 in Clarke, Bennison and Pal, 1997), Applebaun (1966 in Clarke, Bennison and Pal, 1997) and the more recent pragmatic, rule-based approach of property managers and surveyors such as Wiggins (1986 in Clarke, Bennison and Pal, 1997). The three main achievements of this strand in the 1980s and the 1990s are: the building of geodemographic classifications; the growth and refinement of spatial interaction modelling; and the development of geographical information system (GIS). A small number of retailers have now started to use the linking of all three in spatial decision support systems, and this move signals the inception of a phase of more rigorous technique development.

The third strand of the geographical tradition addresses land use planning and public policy issues surrounding retail location. The impact of emergence of new retail formats[33] on the prevailing patterns and structures of retailing have been a major attraction to researchers within this strand[34].

As shown above, the geographical tradition mainly provides an understanding of the critical significance of space and how it is structured. On the contrary, the management/marketing tradition largely deals with how decisions that carry important spatial imprints are reached. The main focus of the marketing discipline is on the distribution of goods from producer to end-user and most marketing literature considers retail location as one element of marketing mix. Consequently, the marketing discipline focuses more on the aesthetic dimension of a 'place' instead of the spatial relationships of outlets to customers, competitors and other elements of their environment that have a spatial imprints.

[33] Such as covered malls and large solus stores

The 1980s started to see a convergence of the geographical and marketing traditions in retail location research. Furthermore, more emphasis has been put on the strategic dimensions of location where consideration is vested to networks and portfolios of stores instead of to individual outlets. This strategic approach to retail location has become even more prominent as dramatic changes in retail environmental conditions occurred in 1990s during which intensification of competition resulting from recession, saturation and rapid growth in internationalisation increased awareness of the importance of location to retail success and led to more diverse and complex patterns of locational decision making (Bennison *et al.*, 1995 in Clarke, Bennison and Pal, 1997). With the intensifying need to plan for the opening and parallel operation of multiple stores within a single market, and across markets, the strategic nature of store location decisions has significantly increased (Ghosh and Craig, 1983 in Kaufmann, Donthu and Brooks, 2000). In order to produce superior and the greatest market coverage in a given geographic area in the long run, the inter-relationship among outlets, both existing and potential, and the impact of the location of an individual outlet on the whole network of stores of a retailer should be prudently taken into consideration in location decision making of each store. Some authors suggest that retailers should plan for the entire array of outlets and select all locations in a single, initial decision (Achabal, Gorr, and Mahajan, 1982 in Kaufmann, Donthu and Brooks, 2000).

The present study shows that all ten international retailers in China, who discussed the issue of the criteria for choosing a store site with the author during interviews, were looking for suitable sites continuously instead of selecting all future sties in a single decision process. Planning and selecting locations for the entire array of outlets in a single initial decision appear to be infeasible in China for at least the time being. The first reason is because modern food retailing only started about a decade ago when foreign investors went into the market. Therefore, there is no data for location analysis

[34] For research work on the formulation and implementation of policy, see Davies (1984 in Clarke, Bennison and Pal, 1997).

available on hand for foreign retailers. Gathering information and converting them into a meaningful database ready for locational analysis takes time, especially considering the geographical widespread of China. Consequently, planning and selecting an entire array of sites were impossible when the author carried her fieldwork. Secondly, land in China is largely controlled by the government. Obtaining land use right for a certain location is very political and time consuming. This makes it difficult for foreign retailers to select all the sites for their retail network at the beginning because of the high uncertainty of how the government will react to the site request of a foreign retailer. Thirdly, China only partially opened the retail sector to foreign investors when most of the interviewees entered the market. At that stage, foreign retailing in China carried an experimental element and opening of a retail business of more than three outlets were not allowed except Makro and Ito-Yokado, who were centrally approved.

Apart from the aggregate level, the strategic approach to retail location also considers the issue at the individual outlet level. Again, much literature has been developed on this subject. The type of sales and hence profitability assessment that retailers make in evaluating sites ranges from pure intuition to the use of mathematical models (Davies, 1995b). Simkin (1990 in Davies, 1995b) claims that the norm would appear to be inclined towards the pragmatic instead of the analytic. Two concepts penetrate much location theory (Davis, 1995b): that retail centres have an attraction due to their relative size; and that this attraction decays rapidly with distance, which implies that proximity to where customers live or work is highly desirable as a location. These concepts are based on the assumption that retail sales are a function of the pedestrian flow (Paver and McLintock, 1935 in Davis, 1995b) and therefore pedestrian flow is one of the most widely used criteria by retail practitioners (Simkin, 1990 in Davies, 1995b). Other criteria that are also widely used are geodemographic composition of the catchment, the presence of neighbouring outlets and the quality of transport at the site.

All of the ten retailers interviewed who were willing to discuss about their site selection criteria reported that they looked at all of the above criteria in their site selection in

China. The General Manger of Company K and the Chief Operating Officer of Company F expressed that they used this same set of criteria all over the world.

Collins (1992 in Clarke, Bennison and Pal, 1997) maintains that a good match between the location and the product is vital to retail success. Dawson and Sparks (1986 in Clarke, Bennison and Pal, 1997) indicate that contrasting formats in different type of retail location can meet varied consumer needs. Obviously, different formats have different requirement on their sites.

The present study found that foreign cash and carrys tend to locate at the edge of city centres where main traffic passes by and where they can hold a car park of about 500 parking slots. Foreign hypermarkets and supercentres in China are usually found at locations away from city centres but close to residential areas with big enough parking space. Foreign supermarkets are largely located in the more populated areas and in city centres.

From the above discussion, it appears that site selection methods of foreign retailers in China are the same as in the Western world. Nevertheless, one must note that site selection process is more based on guessing in China although similar criteria are considered and effort has been put into the attainment of precision. The Vice President, Asia Region of an associated company of Company E pointed out that,

> "Site selection is a exact science in the United States and other developed countries. It is based on accurate data and statistics. China has not reached that level yet. Site selection is still based on guesswork and gut feeling. Many mistakes are made and many stores and companies have folded."

Furthermore, as mentioned earlier, land is still strictly controlled by the government. Searching for and obtaining sites depends to a large extent on what the local governments want to offer. The President of Company D commented that,

> "Site selection is a European question. Remember what happens here: we've got a lot of restrictions and it's not a question of site, it's a question of what you can do. You have to get Central Government's permission. It's a restricted industry. Give you an example. I have been travelling. Say, Chonggqing, I have just been.

There is apparently an agency in that city, plus the resource commissioner. The commissioner and the city is virtually in control of the land. So, they take us around the city and say 'look, there is this, is this, is this. So, what do you want? How much you are going to pay' and that sort of discussion. This means that the problem goes back to the system of state ownership and the governmental system."

This comment also implies that the *guanxi* network of the Chinese partner should be very important in the process of site selection and acquisition.

6.3.3 Availability of Suitable Sites

Only six out of the thirteen retailers interviewed expressed their opinion on the availability of suitable sites for their retail development. Four retailers stated that finding a suitable site was difficult. Two retailers found that there were more than enough suitable sites available for their retail development.

The two retailers (company K and Company F) who were optimistic about the availability of suitable sites operated cash and carry in China. Company K believed that the critical issue was not about availability of suitable site but the administrative process of obtaining the land. The General Manager of Company K stated that,

> "To me, there are just more than enough adequate sites. It's not an issue. If you can sort out the administrative issues related to land, you can find 20 suitable sites for our company here."

Company F claimed that finding suitable site for their company expansion was not a problem because there was always the closing down of factories and hence those sites would be made available to bidders by the government. Nonetheless, both the Chief Operating Officer and the Chief Non-food Purchasing Officer of this company believed that cost of land was going up and competition for land between bidders might increase in the near future.

The four retailers (Companies I, J, E and L) who reported difficulty in finding suitable sites operate either hypermarket, superstores or supermarkets in China. Company E further stated that because of this difficulty, they chose to expand each store's existing business area at the time of being interviewed.

The author believes that the divergence in opinion on the availability of suitable site is due to the differential requirements on site by different retail formats. As mentioned in an earlier section, cash and carry tends to locate further away from city centres when compared to hypermarkets and superstores. Land is relatively more abundant in those locations. Competition for land is relatively low. On the contrary, hypermarkets and superstores in China tend to locate closer to city centres and near residential areas. Less land space is available as it gets closer to city centres and competition is keener. Consequently, it is more difficult to find suitable sites for these formats. The difficulty intensifies for Company J, a supermarket retailer in Beijing, because it preferred sites in city centres.

6.3.4 Store Development (Legal Procedures and Technical Issues)

6.3.4.1 An Overview on Land System in China

The last two decades saw a progressive reform of the land tenure system although the charge of a premium (the form of collecting the total land rent for the entire term of the lease) for the use of land by negotiation, auction or tender still forms only a small proportion of total land transactions nowadays. The majority of land is still allocated administratively to government and quasi-government organisations by a land use fee system that is similar to the collection of an annual land tax. Modern real estate is governed by the Law of the People's Republic of China on Administration of the Urban Real Estate. This law was adopted and promulgated at the Eighth Meeting of the Standing Committee of the Eighth National People's Congress on 5 July 1994 and become effective on 1 January 1995. The real estate law is still far from precise. The law is mainly concerned with principles and policies instead of details, which is typical of Chinese laws at the national level[35] (Walker, Levett and Flangan, 1998). The national

[35] Laws made by the National people's Congress or its standing committee are the highest authority of China. However, they normally resemble statements of general policy and require detailed implementing

law sets out the framework and local governments fill the gaps with implementing regulations after assessing the situation. Investors need to refer to the specific local rules and regulations for details of how the national principles would be applied in the local context. Drafting such regulations takes considerable time and the resulting provisions are flexible so that much discretionary power is allowed to local governments to interpret and implement the national policy. The following figure shows the hierarchy of formal and informal lawmaking and the corresponding legislation affecting construction.

Figure 6.1 Hierarchy of Formal and Informal Lawmaking and Corresponding Construction Legislation

National People's Congress (NPC): 'basic law', 'resolutions', 'decision'	⇒	PRC Sino-Foreign Equity Joint Venture Law and Administration of Urban Real Estate Law
↓		
NPC Standing Committee: 'laws', 'resolution', 'decisions'		
↓		
State Council: 'regulations', 'other normative Documents'	⇒	City Planning Regulations
↓		
Ministries, Commissions and Bureaus: 'rules', 'other normative documents'		
↓		
Local People's Congresses with lawmaking Power (municipal, provincial, provincial Capital, 'quite big city'): 'local administrative rules', 'other normative documents'		
↓		
Local people's governments with lawmaking power (municipal, provincial, provincial capital, 'Quite big city'): 'local administrative rules', 'other normative documents'	⇒	Implementing regulations, detailed technical standards, rules, and procedures
↓		
Local People's congress and governments without lawmaking power: 'other normative documents'		

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regulations. These regulations are usually made by the State Council for national effect and by local government for local effect. Often the lower the level of government, the more detailed are the provisions. Local implementing regulations are intended to interpret the way in which national provisions will be applied in the local context but leave much discretion to the implementers. Clarity only exists at the level of rules and circulars. When conflicts arise between two sets of laws, the one published by the superior lawmaking organ will prevail (Walker, Levett and Flanagan, 1998).

6.3.4.2 Obtaining Land Use Rights

Land use rights are rights for which the State demanded compensation and which have a definite term. Land use right created after 1986 is normally termed "granted land use right"[36]. Foreign investment enterprises established after the effectiveness of the 1994 Law on Urban Real Estate Administration usually obtain this kind of land use rights. Granted land use rights have specified term with a maximum of 70 years[37], have to be used for approved purposes only[38], is transferable but subject to use restriction[39], and is leaseable[40] and mortgageable[41]. Moreover, grantee pays according to the Granting Contract[42]. More specifically, the maximum term of granted land use rights is determined by the schedule of purposes. For commercial purpose, it is normally 40 years[43].

Five of the interviewed retailers in the author's study obtained granted land use right from the government and built their retail complex from scratch. Company F and Company K obtained the right for 40 years. Company G 50 years. Company D and Company L both 30 years. These results imply that the duration of the granted land use right is not fixed as the regulation (discussed above) stipulated and is granted at the discretion of the authority to a certain extent.

Prior to 1999, city or county governments had the authority to grant land use rights in parcels of land of certain maximum size[44]. The Bureau of Land Administration in the

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[36] 1986 Land Administration Law

[37] Law on Urban Real Estate Administration, Section 13. Interim Provisions on Urban Land Use Rights, Section 12.

[38] Law on Urban Real Estate Administration, Section 11, 17. Land Administration Law, Section 55.

[39] Law on Urban Real Estate Administration, Sections 36-45. Interim Provisions on Urban Land Use Rights, Sections 19-27.

[40] Interim Provisions on Urban Land Rights, Sections 28-31.

[41] Law on Urban Real Estate Administration, Section 47. Interim Provisions on Urban Land Rights, Section 32.

[42] Law on urban Real Estate Administration, Section 15. Interim Provisions on Urban Land Rights, Section14. Land Administration Law, Section 55.

[43] 1990 Interim Provisions for the Granting and Transferring of Land Use Rights on Urban State Owned Land in Cities and Towns, Section 12.

[44] If the proposed land use right was for a parcel larger than that authorized to be contracted for by a given city or county, then such agency had to seek the authority of a higher state organ to approve the grant.

city or county was usually the agent to facilitate the granting of the right but the actual land use right contract was between city or county[45].

In 1998, the Land Administration Law establishes a new system called Land Use Purpose Control System, which became effective on 1 January 1999, for authorisation of the creation of granted land use rights. The system calls for an integrated system of comprehensive plans at the National, Provincial, Prefectural, County and Township levels. Cities and counties are now required to prepare a more detailed plan implementing the National Annual Land Use Plan by setting forth specifically the name of each development, the nature of the project, the size of the required investment for the project, the number of parcels and their size, and the character of the preexisting use of the land. These plans must be approved by the provincial governments and the provincial plans must in turn be approved by the State Council.

A party seeking a land use right can initiate a request for that right. The first step is to develop a feasibility plan and submit it for preliminary approval to the local Land Administration Bureau. Upon obtaining feasibility approval, the applicant will proceed to the local agencies that are responsible for approving construction projects, often the local Planning Commission, for another approval. If successful, the applicant will return to the Land Administration Bureau for processing of the land use right itself. The Bureau will determine whether and how to provide the land for the proposed purpose in accordance with the various planning controls. Upon approval at this stage, the applicant will then sign a land use contract.

Alternative means of obtaining granted land use rights are auction and bid invitation. Nevertheless, if the land is intended for commercial, tourist, recreational purposes or for luxury housing, the land use right must be granted by auction or bid invitation "if possible" (Randolph and Lou, 2000).

[45] Urban Real Estate Administration Law, Sections 11, 14.

Foreign-Sino joint ventures in China usually obtain land in one of the ways described above. In some cases, the joint venture company applies to the local Land Administration Bureau for a granted land use right. In other cases, auction or tender, when land is offered on this basis, are used.

All of the five retailers mentioned above obtained their land through direct negotiation with the government. This result appears to contradict, to a certain extent, the regulation that land use rights for land intended for commercial purposes must be granted by auction or bid invitation "if possible", because retailing is a commercial activity and therefore the land use right granted should be by auction or bid invitation "if possible". The phrase "if possible" is very ambiguous and this leaves much flexibility to the granting authority. One reason for the 'discrepancy' could be that the land required by those five retailers is away from city centres. Moreover, these retailers are international retailers with intention to invest heavily into their retail business in China. This was what local governments wanted and needed at the time when they entered China. This very nature of the retailer's investment and their land requirement may explain the 'discrepancy' between the law itself and its implementation.

Apart from obtaining land from direct negotiation, auction or bid invitation, foreign-Sino joint ventures sometimes obtain land through the contribution of land by the Chinese partners. In these cases, the Chinese partners obtain the right to develop a certain piece of land and then contribute the value of the land to the joint ventures. Company M reported that the land on which their retail complex located belonged to and contributed to the joint venture by their Chinese partner.

Company F stated that they always buy land and construct their cash and carry complex from scratch regardless of which country they are in. This is because

> "we can't implement our system the way we want to if we do not get buildings with the exact features we want. We require ground stores. We need to use high racks, about 7.5 m high. Therefore, we need a building of at least 10 m high on the ground floor. We also want to have the customer exit just behind the cashier

> and there must be a covered parking lot coming with the site, which is very important for protecting the merchandise being transported in and out of the store from sun and rain. It is extremely difficult to find a site with the exact requirements we want. Therefore, we always buy land and construct our own complex," claimed the Chief Operating Office of Company F.

Company D, which is also a cash and carry operator in China, developed their stores in the same way as Company F. The President of this company held similar opinion to that of the Chief Operation Officer of Company F at the beginning, but he changed his mind after running the business in China for a few years and learning about the situation. This is what he revealed during interview,

> "Our company usually own and develop our own sites no matter where we go. But in China, after being here for a number of years, I started to think that this does not make economic sense and I am persuading my colleagues that owning and developing our stores is not necessary here. The reason is that the Chinese government is gradually leasing land for only 30 years. A few years ago, they granted land for 50 years. They are shortening the term of granted land use rights now. So, why should I put in so much money at the beginning when I are only having it for 30 years?"

Despite his change of opinion, he did not indicate the chance of their company changing their policy on site acquisition and store development in China in the near future.

In contrast to Companies F, K, G, D and L, companies I, B, A, J and E rented their existing business site. The main reasons for their renting a site instead of getting the land use right and building up their own store were that the former is cheaper than the latter and their retail operations could start in a much shorter time once they decided to invest in the Chinese retail market. The General Manager of Company I stated that if they had to own a piece of land and build the complex from scratch, it would take them at least two years in building the store before they could actually start their business. The Executive Director of Company E pointed out another advantage of renting a site. He claimed that although most of the building available for renting did not match their requirement, they still chose to stick with their renting policy because renting a site was much cheaper so that if they felt that the chosen location was not right at a later time, they could dispose of the store and move to other places relatively more easily. In addition, the sophistication of construction process in China presents a further reason for some retailers' preference to rent a site. The Vice President of Company B made this remark,

> "We like buying exiting stores, because it is easier, no headache on construction, construction is not easy. There are lots of laws and regulations in China for construction. We simply try to avoid that. Therefore, we will just wait for ready made sites."

The complicated procedures and requirements on construction in China will be discussed later. On the other hand, the Direction of Company A and the Buying Manager of Company J (Companies A and J operated supermarkets in China) both believed that supermarket retailers seldom buy land and build their stores from scratch. Supermarket retailers require a large number of stores in order to obtain economies of scale. Therefore, buying land and build stores from scratch do not make economic sense to supermarket retailers. Having said that Companies A and J preferred renting store sites, the Director of Company A pointed out that they never bought existing supermarket stores in China, which he said was very common to retailers in other countries, because the quality of those supermarket stores was poor.

> "The existing supermarket stores that are available for renting in China have no renovation or decoration. A lot of the original merchandise is very slow moving and the equipment is more than ten or even twenty years old and has fully depreciated. Would you consider buying them under such condition? It'd better for us to rent a greenfield site and renovate and build up the inside of the whole store ourselves," stated the Director of Company A.

6.3.4.3 The Approval Procedure for Site Development and Construction Project

A proposal to establish a foreign-Sino joint venture in China frequently incorporates the construction of buildings and other facilities. Joint venture investment proposals and construction approvals are often seen as a continuum of the same process. The state administration system in China is complex and usually presents formidable problems for foreign joint venture partners in obtaining approvals for both the joint venture itself and the construction that they requires. The Vice President of Company B validated this point as mentioned earlier. The General Manager of Company K also shares the same view. He commented,

> "We got the land and then built up the stores ourselves. We used outside contractors. They are local ones. It is difficult to get them because the process is very complicated, let's say, very strictly governmental. First of all, building has to be built according to government regulations. They claim that government standards are optimal standards, but they are not always the best standard. Then, there are regulations for the bidding process of building and that's very much in favour of the government and the construction company and not of the customers. So, it takes time to get to them, build in such ways, to get round the rules and etc."

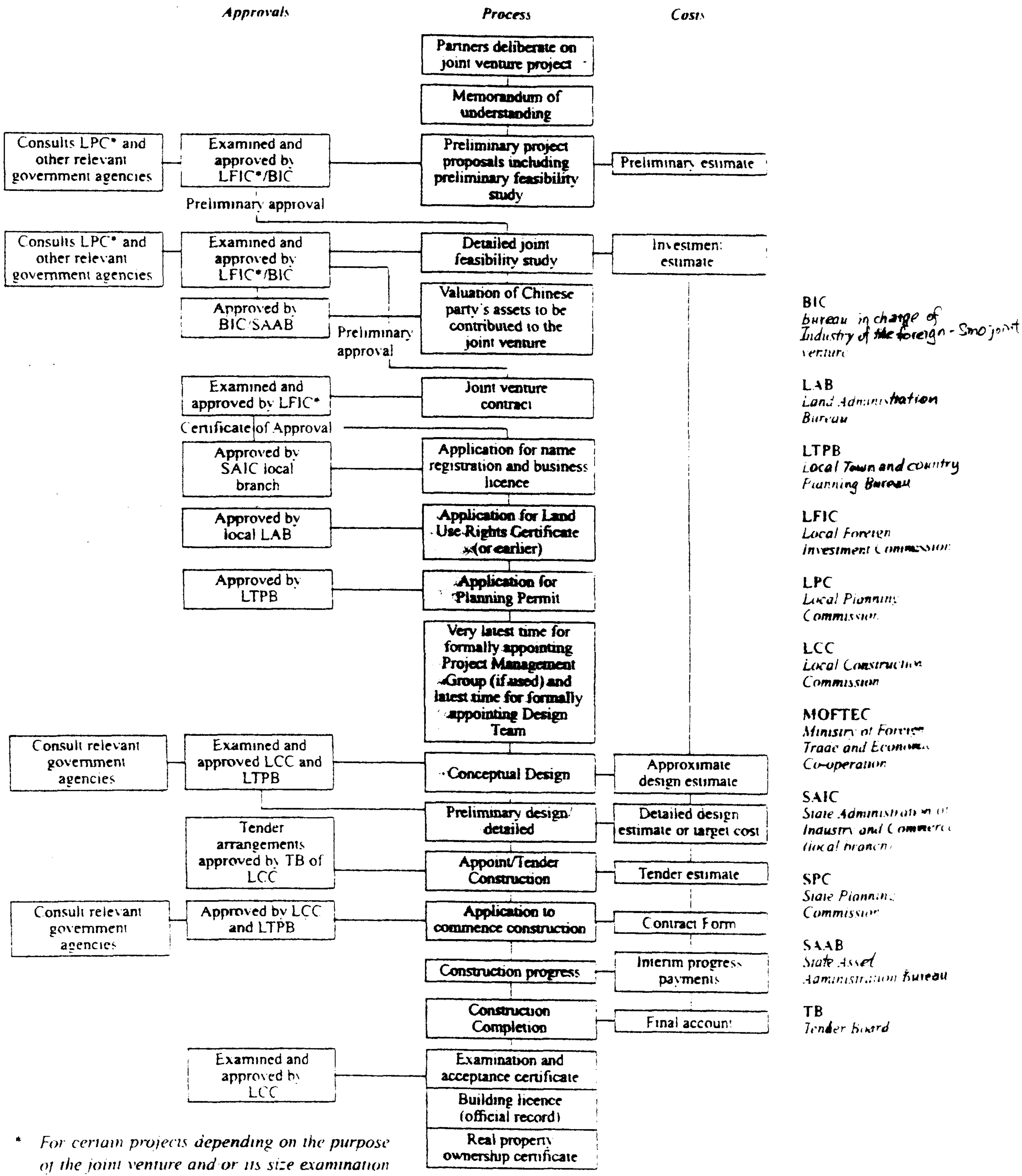
Figure 6.2 presents the investment and capital construction approval procedures for foreign-Sino joint ventures in China. All the steps are clearly shown in the figure.

6.3.4.4 The Construction Market

Before the economic reform, all China's construction companies were state-owned. Projects were allocated to contractors by the government. Prices were fixed on the basis of standard schedules of price. Nowadays, many major construction projects, both domestic and joint venture, are bid by competitive tender among construction companies. Competitive tendering is normal practice in Western markets but to Chinese contractors it was a major advancement from the system of having projects allocated to them.

Since 1994, foreign contractors are permitted to act as general contractors and bid for work for foreign invested construction projects. Simultaneously, local Chinese construction companies are rapidly updating their techniques and are adopting new approaches to management. Despite the progressive changes in the construction industry in recent years, nevertheless, many construction companies remain to operate in a bureaucratic environment in which they are responsible to their local construction commission or their state authority. For example, most ministries control their own construction companies.

Figure 6.2 Investment and Capital Construction Approvals Procedure



* *For certain projects depending on the purpose of the joint venture and/or its size examination and approval may be needed by the SPC, MOFTEC and even the State Council.*

Source: Taken from Walker, A., D. Levett and R. Flanagan. 1998. *Building for Joint Ventures.* Hong Kong: Hong Kong University Press.

Foreign contractors working in China usually subcontract work to Chinese construction companies because there is no other feasible way of carrying out projects. Foreign construction companies are allowed to undertake construction work in China but they are not legal persons and foreign investors are not allowed to set up wholly owned construction enterprises (Fang, 1998 in Walker, Levett and Flangan, 1998). Foreign contractors are only permitted to undertake work for foreign-Sino joint venture clients and some special classes of projects. Furthermore, working in China without collaborating with a Chinese construction company is impractical for a foreign general contractor for problems that they would otherwise be encountered in obtaining local labour and materials, and in dealing with the many parties and government agencies involved.

6.3.4.5 Construction

Currently, there are four options available to a foreign-Sino joint venture company for the appointment of a contractor. They can employ a Chinese construction company, a Chinese construction company together with a foreign construction company that acts in a management role only, a foreign-Sino joint venture construction company, or a foreign construction company that possesses a valid licence and is duly registered. In reality, the project will be built by a Chinese contractor regardless of what option is chosen for reasons mentioned earlier.

For construction projects of a foreign-Sino joint venture client, only Class 1 Chinese contractors will be used. The major Chinese construction companies that are qualified to work on their projects are owned by either the state, province or municipality. The ways by which a contractor is chosen include calling for tenders from a group of Class 1 contractors in the administrative region in which the project is situated or negotiation with a single contractor. The companies invited to tender or selected for negotiation may be proposed by the Chinese partner in the joint venture or the local Construction Commission. The Chinese partner usually has sound knowledge of the strengths and track records of local construction companies or at least is in a good position to obtain such information. Construction Commissions administer and are held responsible for supervising the work of the construction companies that are under their control. These construction companies may include specialist contractors such as building engineering services contractors that are often referred to as engineering installation contractors.

Walker, Levett and Flangan (1998) claim that many of the larger national Chinese construction companies in the major cities have been involved in building 'high-tech' international quality buildings over the past two decades. The level of activity in these construction projects, especially in Shanghai, Guangzhou and Beijing, has been far higher than in the main cities in Europe and the USA.

However, the Buying Manger of Company K claimed that for retailing construction projects, the better contractors were the local branches of construction companies in Hong Kong because they had much more experience in building retail stores. Company D pointed out that they used a Hong Kong contractor in their retail complex development, while Company K employed a local one.

6.3.4.6 Construction Cost

According to Walker, Levett and Flangan (1998), the rough order of construction costs for joint venture projects in China, with the most expensive first, is Japan, United Kingdom, Hong Kong, Australia, the USA and then China.

6.3.4.7 Design

Foreign design practices are required by a regulation issued by the State Development Planning Commission to work with Chinese design institutes. Foreign designers' drawing and specifications must be checked, approved and stamped by a design institute to signify approval.

Commentators claim that the design institutes in China adopt similar practices to foreign designers (Walker, Levett and Flangan, 1998). They use a large range of standard design details for parts of local projects and are using computer-aided design packages to produce working drawings.

Seven retailers in the study mentioned that they used much of their parents' expertise in the store development and design in China because this is crucial to the retail business. The President of Company D stated,

> "We control the building design because the function of the building is crucial to the economics of the business and so we are keen to bring in that expertise. We have a consulting group in our home country who has built a lot of our stores in different countries in Asia. So, we know exactly what we want in a building."

The General Manager of a closely associated company of Company L also made a similar point. He asserted that Company L was very keen on abiding by their company rules on the feature of the building and the interior design of the stores in China because they believed that these were critical to their retail operations. Therefore, the store development and interior design of Company L involved a specialised team from their home country[46]. Company B also employed some engineers in their home country in the process when they first entered China.

6.3.5 Political Opposition from Local Retailers

When compared to most local Chinese retailers, the foreign retailers that have entered the Chinese market are much better off in terms of capital, expertise and technology. Therefore, foreign retailers present great threat to the local retailers' survival.

Six retailers in the present study reported that they had experienced political opposition from local retailers in one way or another. According to the interview results, the political opposition from local retailers ranges from informal lobbying by the local retailers to their local government against the development of foreign retailers, to disturbance on foreign retailers' operation (see examples following), to creation of negative propaganda.

[46] Further details on in-store fixtures and fittings are not pursued in the present study.

According to an Agricultural Specialist of US Agricultural Trade Office, once there was an eye-catching "news report" article in a local paper saying that a Chinese consumer was suing Company D for damages because he was beaten up by the security guard of the company for something he had not done. This happened only a few months after the opening of Company D. The Agricultural Specialist highly suspected that this story was generated by local retailers in an attempt to tell people that Company D was not a good place to shop. He also revealed that a year before this incident, there was a big lawsuit suing Company B by a local person who bought a television from Company B. The person claimed that Company B mis-advertised the television as a product from the USA but it was actually produced by an American joint venture located in Shenzhen. He therefore sued Company B for misrepresentation. The Agricultural Specialist believed that there was a high chance that some local retailers were behind this incident.

A similar story was provided by the Executive Director of Company E when describing the kind of political opposition that they encountered from local retailers:

> "There is some political opposition. When their business can't compete with you, they will use some people to disturb you. For example, it is easy to give you trouble, because the system in China is very sophisticated. They can get an official into your store, collect a bottle of air sample and take it to test to see if your polluted level exceed the standard or not. Or go to your kitchen saying that you are dirty and then tell you that you have to clean it up and improve the hygiene standard before you can open and use the kitchen again. There are so many of such tricks in China. China has problem in this sense."

Nevertheless, the Executive Director of Company E claimed that such political opposition would not be able to affect their operation and development in China to a significant level.

> "Our company has established quite a good relationship with the local government so that we also 'know people' in the government, not only the local retailers do. So, if there is any problem between us and the local retailers, we both know people in the government and hence we can usually sit down to solve the problem."

Apart from Company E, all of the other five retailers who reported opposition from local retailers stated that their business and development was not materially affected by those oppositions. All of them mentioned that their development in China was supported by the local governments and the governments in China in different levels largely ignored the opposition of local retailers against foreign retailers. Even if local retailers complained directly to local governments, the foreign retailers felt that the government did not care and would not take any action. Furthermore, the Chief Non-Purchasing Officer of Company F firmly believed that as their company gradually benefiting the community, their image and business would increasing be immune from being damaged by negative propaganda created by opposing parties. The Chief Food Purchasing Officer and the Chief Operating Officer of the same company further pointed out that there should be no reason for local retailers to oppose their company's development because they did not target the same customers. Company F targeted professional customers while local retailers targeted individual consumers. Therefore, they alleged that when the local retailers slowly learned this different nature of their business, the opposition would disappear.

6.4 Conclusion: Relationship Between Foreign Retailers and Chinese Government at Different Levels and its Importance

This chapter accounts for some of the basic legal and regulatory infrastructure that foreign retailers face in China, the various issues relating to mode of entry, such as partner selection, ownership and share of managerial control between partners, and site selection and store development procedures and processes. Highlights of some important stipulated laws and regulations related to these three issues are presented, and the views and experience of foreign retailers on the three issues discussed. The materials presented in this chapter demonstrate that all market entry related issues in China involve onerous and complicated administrative procedures and require good relationships between foreign retailers and the Chinese governments at various levels. One reason for the present situation is the legacy of the state-owned system. Another reason is that Chinese economic and law reform still has quite a distance to go before systems becomes well designed, organised, managed and implemented in the Western standards. The remedy for this 'problematic' Chinese business context is to establish good relationships with governments at different levels.

Ten retailers interviewed explicitly pointed out that having a good relationship with governments, either local, of a higher level, or the Central Government, was crucial to their business development in China[47]. Both Companies F and B stressed that this relationship was important in getting business licences and other permissions in their business development. This point is best illustrated by the comment of the Vice President of an associated company of Company E,

> "Nothing is easy to do in China. It is always best if you have connections of some type. Company E has been doing other business in China for many years. If it was not for their connections and relationships that they have built over the years with government organisations, their retail entry to China would still be just an idea. There are countless barriers in doing business in China, the red tape is endless and fees for foreign companies, public services, taxes, etc. you need to know someone local well to help you to get through these barriers, or else you will be eaten up very quickly."

Having the relationship, according to the Chief Food Purchasing Officer of Company F, could also means having support from the governments against opposition against their company by some interest groups.

Six retailers mentioned that they had performed joint activities with the local governments. These activities range from holding seminars, helping with training courses, to sponsoring community events. For illustration, the Chief Non-Food Purchasing Office of Company F said that their company had organised seminars for government officials who were in charge of the industry and some Chinese retail operators several times to introduce them the concept of cash and carry, and worked

[47] There was no discussion on this subject with Company A during the interview because of the refusal of the interviewee.

with governments to organise trade shows. Company B had also held seminars for government departments that were in charge of the retail industry to teach them about retailing. They once held a large-scale seminar for local retailers in Shenzhen to introduce them about mass retailing, and a seminar in Beijing on distribution centres. Similarly, Company J had held several training sessions on retailing for local governments. Company H had also done the same for their local Commercial Committee. On the other hand, Company E, according to its Financial Executive Director, had provided assistance to the local China Store Association in the following way,

> "A lot of times, when they go abroad, we have arranged for them to visit our associated companies in those countries they went to, such as Australia. On the other hand, when they have to go abroad, they will ask us to help them to write recommendation letters. We will do it for them. Sometimes, we help them with organising seminars together, arrange trainers to come to China as speakers. This is our relationship."

The kind of joint activities that Company K and Company C had done with the government were different from those described above. Company K once sponsored a community event for young people organised by the district government. Company C mainly concentrated on organising joint environmental conservation activities with the government. Most of these companies believed that besides having a good relationship with the government, they also need to contribute to and be a part of the community.

Up until the time when the author's fieldwork was carried out, nine retailers claimed that they had been having strong support from their local governments for their business development and expressed that their relationships with the governments were good.

One should note that in China, when relationships are involved, the main focus is on personal relationships. This point was stressed by the CEO of Company F. He further added that,

> "You never know who is the one to make the final decision, and therefore we need to focus widely on building relationships with a broad number of people..."

Establishing good relationships takes considerable time and effort because trust, a crucial element, can only be built gradually through increasing interactions between the parties involved. Economic exchange transactions are minor ones at the beginning and little trust exists between the parties engaged in the exchange. The parties can then prove their trustworthiness through these transactions and trust is slowly built up. Subsequently, a social exchange relationship emerges. Hallen (1992) further proposes that such a social exchange relationship provides underlying preconditions and support for industrial and business activities in international business. In the case of the establishment of relationships between foreign retailers and local parties involved, such as government officials and local suppliers, economic exchange transactions may not necessarily be involved at the beginning. Nevertheless, trust between the parties can still be built up gradually as their interactions (such as those described in the last paragraph) increased. The relationship hence established will then provide support for business activities of foreign retailers in China. The time and effort required to establish relationships is a business a cost. However, Thorelli (1986) and Easton (1992) maintain that a good network of connection reduces uncertainty, enables fast access to information, and increases reliability and responsiveness in a business context. They argue that the gain far outweighs the cost.

As relationships can only be built through actual interactions and knowledge, especially tacit, of China, and can only be learned through operating business in the context, it is logical to argue that investing in China at an early stage, when the systems there are not fully developed and the market not fully opened yet, offers foreign retailers golden opportunities to establish useful relationships and accumulate knowledge, both explicit and tacit, of the market. The relationship and knowledge, in turns, will leverage them advantages over late comers in the future.

One may argue that once the system in China improved and become closer to international standards, the advantages leveraged by the relationships that earlier movers have established will not be sustained. However, one must notice that the context in question is China and the people involved are Chinese. The importance of and reliance on relationships and networks in overseas Chinese[48] business dealings are well documented (for examples, Redding, 1993, 1995; Wong, 1992; Whitley, 1992; Pyatt, 1995a, 1995b). Relationships and networks have attributed strongly to the success of most Chinese businesses over decades because they allow much flexibility to business transactions. A commentator (in Kao, 1993) remarks that "doing business is like driving a car......in Taiwan, even if the light is red somebody can get through it. If it's green, there still aren't rules to tell you how to go." Following this line of argument, *guanxi* (relationship) will always remain one very important characteristics of Chinese communities in China and remain a crucial element in which business dealings are embedded regardless of how the legal and economic system in China will change in the future. Therefore, the relationships that foreign retailers have built up and the knowledge of local culture and market that they have learnt through their experience now will still provide them advantages in the future.

Furthermore, the experience of doing business in China, a highly relationship-oriented context, is valuable to company's international expansion in many other East Asian countries, especially as Japan and South Korea. This is because reliance on relationships and networking instead of clear rules and regulations are also paramount in the business context in many East Asian countries (Alston, 1989; Whitley, 1992). There is no doubt that the forms and features of the type of networks in different Asian country, for example, between Chinese business networks and Korean *Chaebol*, is different. Nevertheless, the most crucial part of the learning process of foreign retailers is not the accumulation of the explicit part of knowledge but that of the tacit part, which in this context, is the mind set and capability needed in working in a business environment in which rules and regulations are not as heavily relied upon as relationships and networking. This tenet of learning is discussed in more details in the next chapter.

[48] Overseas Chinese includes Chinese people in Hong Kong, Taiwanese, Singaporeans with Chinese origin, and all other people residing outside mainland China but with a Chinese origin.

Chapter 7 Transfer of Retail Expertise & Operational Issues

Chapter 7

Transfer of Retail Expertise & Operational Issues

The extent and impact of retail internationalisation has become increasingly prominent in the last fifteen years. Internationalisation has appeared to be inevitable for those Fast Moving Consumer Goods (FMCG) retailers who desire to maintain a strong and competitive position in the marketplace. Owing to the opportunities offered in transitional economies in recent years, several Western FMCG retailers with their 'superior' retail expertise have ambitiously expanded their operation domains into these largely untapped markets. Modern Western retailing has evolved over a long period of time in Europe and North America, whereas structured retail development in transitional economies, such as China and Central Europe, only began about a decade ago. Therefore, there is a gap in the level of retail development between the developed countries and the countries in transition. This provides retailers from developed countries with an opportunity to exploit the under-developed retail industry in transitional economies. Due to the differences in economic, social, cultural, technological and political conditions between the developed and the developing countries, retailers are confronted with many complications when they transfer their retail expertise from their developed domestic countries to the developing host countries. This is because their retail expertise is rooted in a specific set of underlying social, economic and political preconditions and level of infrastructure development.

This chapter discusses the complications that foreign FMCG retailers encountered in their process of transfer of retail expertise from their domestic base into China. Particular attention is focused on three aspects of retail expertise: supply chain management, retail formats and corporate culture. The first section presents an analytical framework of international flows of retail expertise. The next section investigates issues relating to supply chain management in China. The third section analyses the extent of adaptation that foreign retailers made to their formats. The fourth section evaluates the human resources policies that foreign retailers adopt. The chapter concludes with the importance of learning processes to international retail operators.

7.1 Analytical Framework of International Transfer of Retail Expertise

7.1.1 The Concept of Retail Expertise

The term "retail expertise"[1] has not been well-defined in the literature. Kacker (1988) defines it broadly as the business concepts, operating policies and techniques employed in a retail business in a given environmental setting. He further suggests that the term includes two elements: the managerial element, which embraces concepts, policies and systems; and the technical elements, which are the techniques employed in areas such as site selection and store layout. Drawing on Bucklin, Betancourt and Gautschi, Ghosh, Goldman, Hollander, Kacker, Manson and Mayer and Messinger and Narasimhan, Goldman (2001), on the other hand, advocates that "expertise" is one element of "format" and "offering" is the other element. "Expertise" is the internal part of a retail format that determines a retailer's operational strength and strategic direction whereas "offering" is the external elements that are related to the delivery of the functional, social, psychological, aesthetic and entertainment benefits that attract customers to stores. These conceptualisations of retail expertise are vague and inconsistent.

Building from the existing literature, a more comprehensive concept of "retail expertise" is presented in this section. Retail expertise identifies the main elements that define a retailer's strategy, which in turns determines the retailer's competitive position in a market. The author identifies three components to retail know-how: retail technology, retail format and corporate culture.

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[1] Some authors used the term "retail know-how" instead. There are two terms are used interchangeably, carrying the same meaning, in this thesis.

7.1.1.1 Retail Technology

Retail technology[2], according to Goldman (2001), contains the systems, methods, procedures and techniques that a retail firm employs; and determines the firm's operational strength and strategic direction. Therefore, the author suggests that it comprises four areas. First, there is information technology, which a retailer uses to manage the flow of information, physical materials and finance throughout the whole supply chain. Second, there is supply chain relationship management, which is about selecting and negotiating with suppliers, and establishing and maintaining relationships with them. Site selection and store development is the third area. The fourth area is cash flow management, which is mainly about the retail financial formula for different formats. This chapter deals with the first and second area. The third area is the focus of the last chapter. The fourth area will not be discussed because it is outside the scope of this thesis.

7.1.1.2 Retail Format

Retail format is the second component of retail know-how. It is the physical elements of a retail outlet that is visible to consumers, such as assortment, store atmosphere, services inside the store, physical location and price. Simultaneously, each retail format comes with a specific cash flow and ROI management philosophy.

7.1.1.3 Corporate Culture

Goldman (2001) claims that retail culture consists of concepts, norms, rules, practices and experiences. It determines a retailer's ability to evaluate situations, identify trends and opportunities, and deal with problems. A retailer must have a learning-oriented culture in order to be competent in these tasks. Organisational learning, which is defined as the capacity or process within an organisation used to maintain or improve performance through experience (Nevis, DiBella and Gould, 1995), provides an approach for continuous adjustment of organisational issues and knowledge utilisation in a turbulent competitive climate (Kiernan, 1993; Stata, 1994 in Morgan, Katsikeas and Appiah-Adu, 1998). Retailing is an industry directly interacting with consumers. With rapid development of technology and intensifying competition, together with rapid changes in consumers' taste, retailers could not sustain their favourable positions in the market without a continuous fine-tuning of the organisation and its processes. In other words, retailers could not survive in a turbulent competitive environment without a learning orientation.

The capacity to learn is termed organisational capability. Grant (1996a in Morgan, Katsikeas and Appiah-Adu, 1998) considers the concept of organisational capability within the boundaries of a knowledge-based view of the firm. He advocates that analysis of the organisation as an integrator of knowledge is an appropriate frame of reference for researchers to diagnose organisational capability. He further interprets it as a consequence of complicated assimilation of knowledge, where productive activity is a function of the firm's capacity to harness and integrate knowledge attributed to multiple individuals and groups. It is important to emphasise that organisational capability depends on the firm's mechanisms and processes of knowledge integration, not simply the extent of knowledge that individuals and groups possess per se.

Owing to the highly dynamic nature of the market environment, effective organisations are always loosely coupled in order to maximise the buffer effect between them and their environments. Organisational capability can act as such a buffer in the following four aspects (Morgan, Katsikeas and Appiah-Adu, 1998). First, learning activities are always designed and organised according to the predicted future circumstances with the aim of minimising the incidence and potential impact of serious environmental disturbances. Secondly, since learning organisations usually enjoy good relationships with suppliers, customers and related constituencies, an attitude of mutual accommodation is evidenced when anticipated problems arise. Thirdly, flexibility within the learning organisation means that rapid company responses are possible in order to exploit and respond to emerging opportunities or threats. Finally, information usually flows efficiently within learning organisations and this leads to significant reduction of transaction costs and economies of information.

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[2] Note that the term "retail technology" in this thesis does not only mean "information technology".

According to the above conceptualisation of 'retail know-how', the concepts of self-service and discounting within specialty retailing is an example of retail know-how and this retail know-how is manifested in the format of a category killer, such as Toys R Us. The concept of one stop shopping, department-based store design, and a merchandise mix of soft and hard items is another example of retail know-how, which is transformed into the format of a department store.

7.1.2 The Vehicle of Flow

'Flow' is the movement of retail know-how from one enterprise to another within the same regions or between different regions (Kacker, 1988). There are two different kinds of flow. A flow that is unplanned or incidental is called diffusion. Diffusion may take place during overseas business trips and in professional meetings or seminars. A flow that is planned and purposive is called a transfer. The vehicles of transfer include foreign direct investment, management contracts, franchising and supply of equipment and support services. Only deliberate retail transfer is discussed as diffusion is by its very nature difficult to identify and measure.

7.1.3 The Flow Process: Preconditions, Problems and Consequences

"No technology or innovation evolves in a vacuum" (Kacker, 1988:44). Retail technology or concepts are created to respond to human needs. Human needs, in turns, are shaped by a given social, cultural and economic environment. The development of retail technology is also constrained by dimensions such as information technology and political regulation. Retail know-how thus evolves in response to different contexts. Retailing know-how that is developed in an environment with a certain family size distribution, store patronage patterns, levels of retail industry growth, urbanisation and presence of supportive infrastructure may not be effective in an environment with different business conditions. In other words, the environmental dimensions of a host country affect the effectiveness of retail know-how transfer. Field investigation and analysis of secondary data reveal that the

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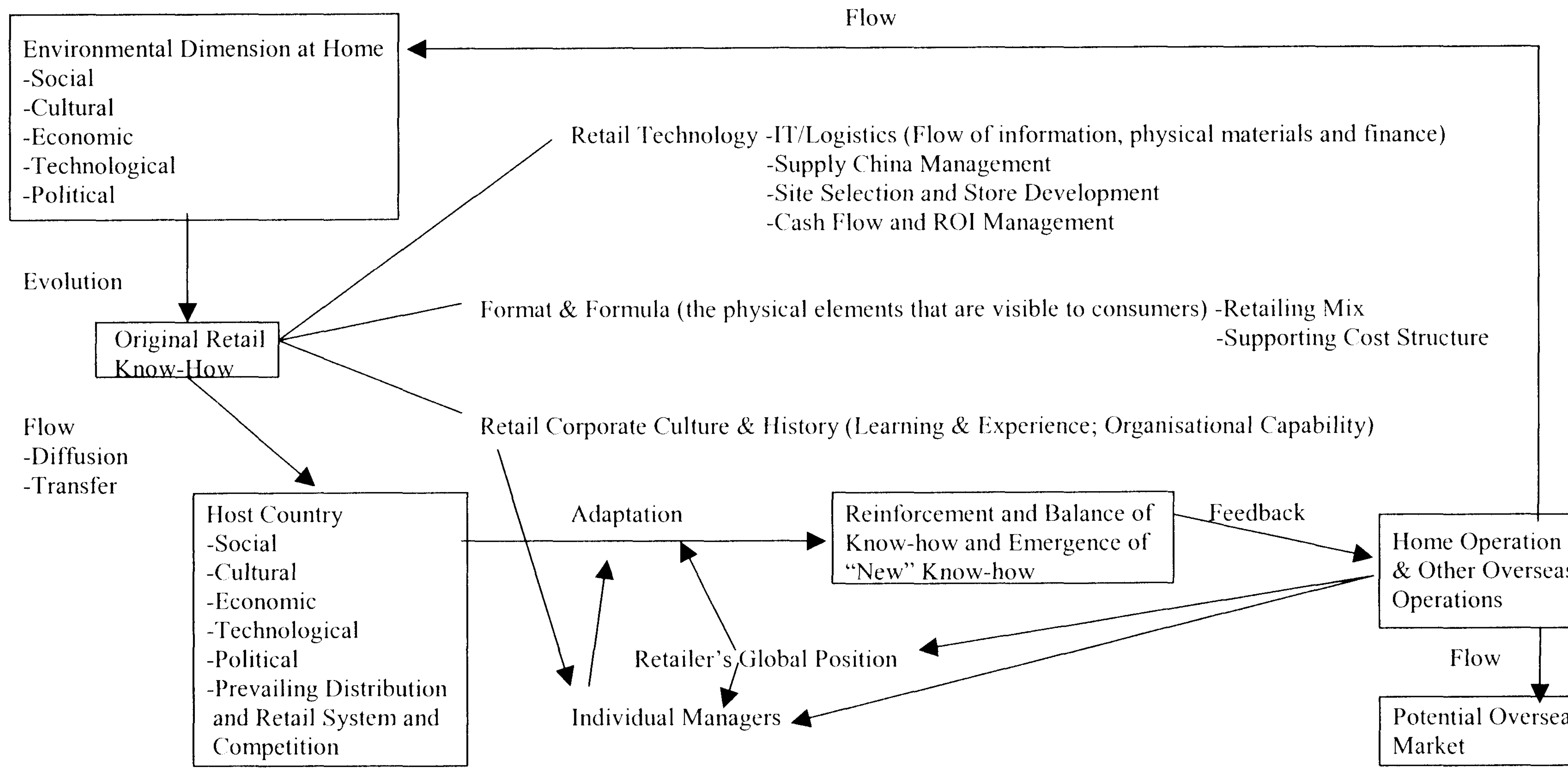
This term is used to mean "ways of doing the various aspects of retailing".

process of transfer of retail know-how may experience serious problems in the absence of certain preconditions or basic infrastructure (Kacker, 1988). Consequently, a retailer may need to adjust the original retail know-how that they intend to transfer in order to adapt to the host environment.

Apart from the environmental dimensions, Goldman (2001) believes that the global position of a retailer also affects the adjustment of their retail know-how in the host country. When deciding how much adjustment to undertake during the process of retail know-how transfer, a retailer must consider the following four factors. The first factor is scale economies and standardisation that global sourcing of products and equipment, standardisation of operations, elimination of duplication and the global use of specialised skills can derive. The second factor is experience and learning that can be generated by operating in diverse environments. The third factor is global flexibility that enables retailers to move resources, expertise, innovative concepts and methods across countries. The last factor is specialisation that a retailer can enjoy by serving global segments.

The environment of the host country and the retailer's overall strategy at the international level determine the extent of adaptation that a retailer undertakes in the host country. As a retailer continues to fine-tune their retail know-how in response to the environmental factors in the host country, "new" retail know-how emerges. Following the tenets of organisational learning, this know-how should then feed back to headquarters in the home country to enhance the capabilities of the retailer as a whole and another flow cycle of a "new" retail know-how begins. Figure 7.1 presents an analytical framework of the international flow of retail know-how.

Figure 7.1 Analytical Framework of International Flow of Retail Know-How



7.2 Retail Technology: Supply Chain Management[3]

Proper management of the supply chain is vital to the long-term success of a retailer. This section discusses three aspects of supply chain management. The first aspect is about the distribution structure in China, which is different from the kind of structure foreign retailers are used to.

The second aspect is logistics, which involves the coordination and management of the actual flow of products and the terms of supply contracts. Transportation infrastructure in China has not been well developed and this makes the physical movement of goods inefficient. Therefore, logistics is one aspect to which foreign retailers should pay particular attention.

The third aspect is management of supplier-retailer relationship. As is described later, intermediaries in the distribution channel in China are accustomed to operating and surviving within volume-oriented channels but not with customer-oriented channels. They may fail to recognise the strategic role of marketing channels in a firm's overall marketing strategy. They may also not be oriented towards performing complicated marketing tasks. The nature of suppliers will hinder the cooperation between foreign food retailers and their local suppliers and hence encumber the whole channel performance. Some scholars argue that this problem can be solved by establishing a trusting long-term relationship between buyers and suppliers because a trusting long term relationship can facilitate the transfer of modern retailing know-how from retailers to suppliers and hence improve the marketing function of local distribution channel.

Redistribution structure in China, logistics issues and relationship between retailers and suppliers are discussed in more details in the following sections.

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[3] As mentioned in the section 7.1, this chapter deals with issues related to logistics and supply chain relationship management.

7.2.1 Empirical Results: An Overview

Based on the thirteen case studies, the following areas were found to be of main concern when foreign food retailers transferred retail technology. First, the distribution structure in China is quite different to that in the home countries of foreign retailers. In China, most foreign retailers had to go through more middlemen than they had to in their home countries. Secondly, there was very low involvement of information technology systems on the side of Chinese suppliers. Thirdly, the quality control on the side of Chinese suppliers was poor. Fourthly, suppliers performance in terms of timely product delivery and supplying the right quantity in China was lower than that of the home countries of foreign retailers. This is largely due to the poor transportation infrastructure in China. These areas are investigated in more details in the following sections.

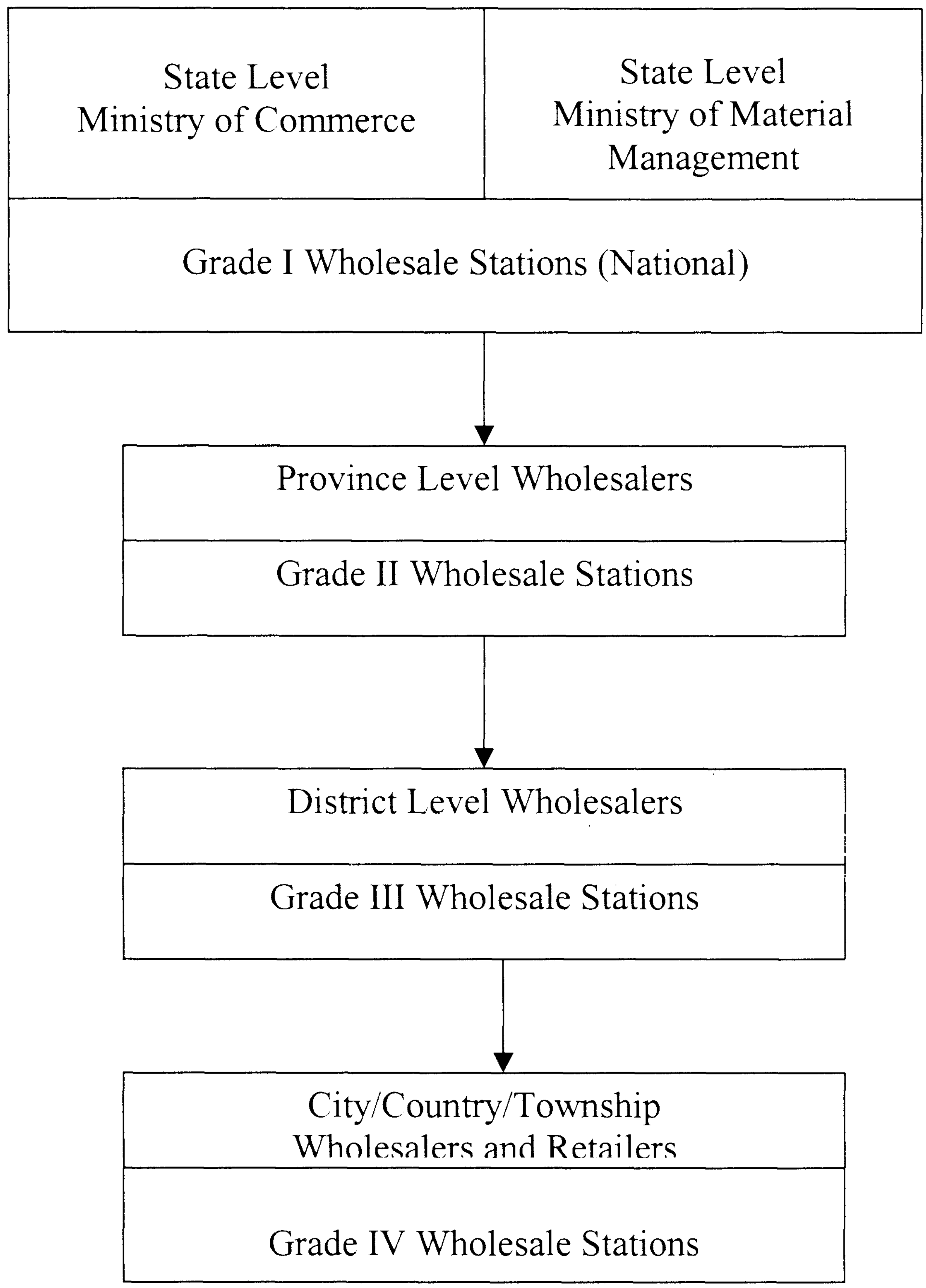
7.2.2 Distribution Structure in China

Under the command economic system, in order to control the flow of commodities, a three-tier distribution system, as illustrated in Figure 7.2, was adopted by the Chinese government.

Traditionally, all kinds of commodity procurement were performed by state-controlled agents at different levels and distributed by state-owned wholesalers from the state level down to the lowest administration level. Under this structure, there were two types of organisation operating in parallel: planning and administrative organisations; and operational organisations. The former provides information that was needed in the formulation of the state's economic plan and co-ordinates the corresponding business activities. The latter implements the stipulated economic plan. The marketing channels that existed under this system could be classified in two ways. First, they could be classified by the extent of their affiliations with the Ministries. Under this classification, marketing channels in China were divided into those operating within the commercial system and those operating in the non-commercial system. The second way to classify marketing channels was by the nature of ownership. Three types of channel could be identified this way: the state-owned distribution network, the collective distribution network and the individually, privately owned distribution network. In the state-planned economy, most marketing channels operated within a narrow, specific domain. The government predetermined their business scope in accordance with the economic plan. Market forces were suppressed. Distribution was monopolised by state-owned commercial units in city districts and co-operatives in the countryside. Consequently, a highly rigid and inefficient distribution network covering both wholesale and retail activities resulted. Such distribution suffered from a number of weaknesses:

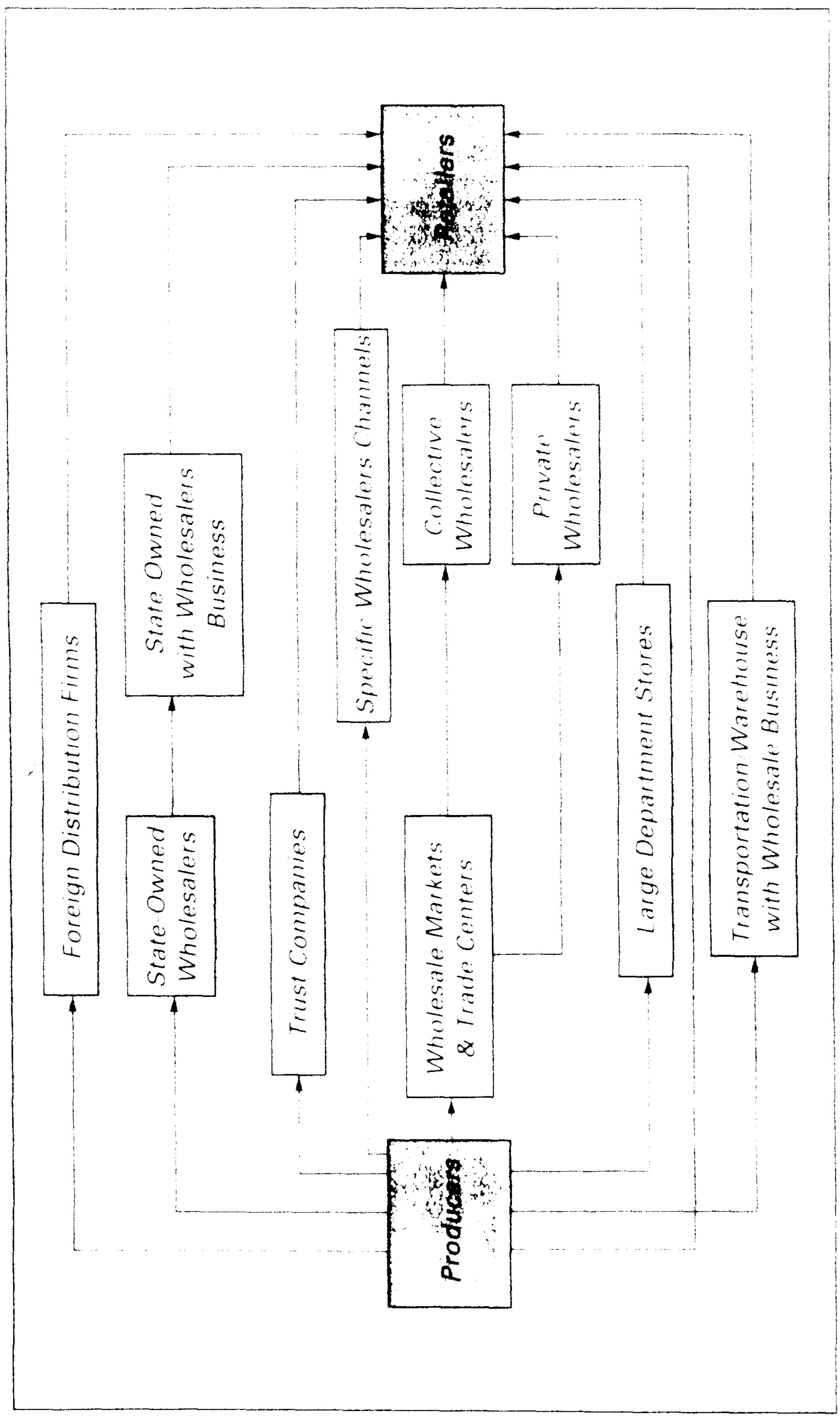
- Members in the distribution channel performed hardly any value-added activity. They were only responsible for the physical movement of commodities (Iwinska-Knop in Luk, 1995).
- Manufacturers were sometimes deprived of access to the required raw materials for production. Subsequently, the changing customers needs could not be matched. Moreover, a black market of production materials was created, which led to intensified problems of bribery and speculation (Gajewski in Luk, 1995).
- The rigidity of the administrative mechanisms encumbered the smooth circulation of goods. The consequence was the build-up of unnecessary inventories in distribution centres at every level of administration. Extra operational cost for these inventories was therefore incurred.
- Horizontal interaction amongst commercial enterprises at the same administrative level was restricted. Therefore, exchange of market information amongst firms from different provinces was extremely difficult and they had little choice but to localise their operations.
- As members in the distribution system merely existed for administrative purposes, they were only motivated to pursue the political interests of the ministry instead of the satisfaction of customers' needs.
- No alternative means were available to contact foreign manufactures or suppliers other than through import/export agents affiliated with the ministries.
- Distribution channels only aimed to set in quantitative terms and hence were incapable to market differentiated products.

Figure 7.2 The Traditional Wholesale Distribution System in China



Adapted from Luk, Xu and Ye (1998)

Figure 7.3 Wholesale Distribution Channels in China after the Distribution Reform



Adapted from Luk, Xu and Ye (1998)

The above weaknesses became increasingly noticeable as the Chinese economy grew. Therefore, modification to the distribution system was one of the prioritised items in the government's economic reform (Luk, 1995). A new distribution system was then created (Figure 7.3). The major changes made by the distribution reform are described in the following (Luk, 1995; Luk and Li, 1997).

- A new commodity circulation system has been established. In this system, state-owned commerce plays the leading role. Collectives and individuals are encouraged to engage in the circulation of commodities by all kinds of methods and through a variety of channels. A new city-based wholesale system comprising multiple channels but fewer intermediate links has also been introduced. In addition, a comprehensive network has been created to ensure smooth flow of commodities between town and county and between different regions.
- State-owned channel members have been given more autonomy in setting their own business scope, pricing strategies, staffing and income distribution.
- More horizontal interaction among economic enterprises, especially those located in different regions, has been promoted.
- Corporations have been reorganised at the state level. The aim is to streamline administration of the commercial sector, improve internal management of commercial enterprises, avoid duplication of resources and functions in government departments and facilitate the cultivation of a more market-oriented system.
- Sino-foreign joint ventures have gradually become the authentic channels to the domestic market considering the transaction volume that they are allowed to handle. Moreover, both central and local governments are now increasingly more flexible in applying domestic sales quota on such joint ventures.
- There has been dramatic increase in commercial establishments of different kinds of ownership and fast, parallel expansion of the retail sector.
- With greater autonomy in the management of purchasing and marketing activities, channel members at all levels are becoming more active in selling their products directly to customers than before. Expansion in business scope

has been witnessed in many commercial enterprises. Competition within the distribution sector has also intensified.

- The influence of state-owned wholesalers in marketing channels has been gradually declining because of their inflexibility and inefficiency of operation.

Despite the restructuring described above, distribution in China can still be difficult (Tseng, Kwan and Cheung, 1995).

In China, foreign retailers have to go through the wholesale market and various agencies for most fresh food products. According to the author's field work, only two retailers claimed that they dealt with farmers directly for fruit and vegetables. Three retailers reported that they partly dealt with farmers and partly dealt with agencies or wholesalers. The other eight retailers always went through intermediaries. For meat products, all of the foreign retailers interviewed had to buy from slaughter houses because it is stipulated in government regulations. For many other products, most retailers normally went through agencies instead of dealing directly with manufacturers, which is what they preferred normally. According to the Chief Non-Food Purchasing Officer of Company F, this is

> "because of the existing distribution network system in China. When a manufacturer tries to sell product in China, they cannot do it themselves because there are no national chains established yet. So, what they do is that in each city, they appoint dealers. Their dealers then have the authority to sell their products in that area. In the supply chain between manufacturers and retailers, there are many tiers. You will have a regional distributor, and then a lower level and then another lower level of distributors. This system of distribution has been running for the last twenty years. Before that there was the state-owned distribution system, which was also similar. You went to the provincial distribution network, then into the district and then the city level distribution network. Although the state-owned distribution system no longer exists, each vendor has their own distribution network. The dealers in Shanghai do not have the right to sell in say Nanjing because Nanjing is the territory of another dealer. The right to sell is exclusive. Therefore, when the foreign retailers come in, we still need to deal with these local networks although we are in the process of reducing the number of layers that we have to go through."

The Executive Director, Finance, of Company E pointed out that multinational manufacturers in China such as Proctor and Gamble and Nestlè stipulated that buyers must buy from their appointed distributors. This contradicts Goldman and Qin's (1998) allegation that multinational producers behave differently from indigenous producers in that multinational producers tend to maintain direct contact with grocery stores. One reason for using distributors, the Executive Director, Finance, of Company E claimed, is because in China, especially in Guangzhou, many local retailers have a tendency to evade tax and therefore prefer purchases from producers without proper invoices being issued. Consequently, multinational manufacturers preferred to use distributors so that they did not need handle this complicated issue themselves.

On the other hand, the Executive Director, Finance, of Company E added that the norm of having intermediaries in the distribution channel in China had something to do with the nature of the merchandising system in China. He pointed out,

> "A lot of buyers choose to buy from distributors instead of from manufacturers because they have established some kind of personal relationship with the distributors. They have a lot of 'under-table' deals. This practice was 'nurtured' through many years in the past and has become the 'norm'. However, we believe that the market is changing slowly and this practice will disappear in the near future."

The Chief Food Purchasing Officer of Company F claimed that although they could not deal directly with Nestlè but must buy from Nestlè's distributor, their purchasing price was the same as if they dealt directly with Nestlè because of their world-wide relationship with Nestlè and its volume of purchase in China.

On the other hand, when smaller manufacturers are concerned, the Chief Food Purchasing Officer of Company F stated that they preferred to go through intermediaries in China because intermediaries would take care of everything related to transportation.

For vegetable and fruit, the Chief Food Purchasing Officer of Company F claimed that producers in China were quite fragmented compared to those in Europe. The General Manager of Company I shared a similar opinion. He pointed out that the scale of most farms in China was too small and therefore their company had to buy from many farms in order to obtain the quantity they required. Consequently, going through cooperatives was a better way to get the quantity and quality they required. The General Manger of Company K offered another reason for their practice of buying from cooperatives instead of farms for vegetables and fruit. He said that in China, the government required their company to document proper VAT invoices for all their purchases and sales. He claimed that most farmers in China did not want to follow this rule and hence did not want to issue proper VAT invoices so that they could evade some tax. However, he stated that their company does not want to break any rules and therefore would buy from cooperatives where VAT invoices would be issued for all purchases.

7.2.3 Logistical Issues Concerning Foreign Food Retailers

Logistics has become increasingly significant to firms in their strategic planning process since the 1970s (Carter, Pearson and Li, 1997). In order to remain competitive, firms must utilize logistics function to enhance certain strategic advantages such as more efficient distribution networks, improved quality, reduced total cycle time, better post-sale service and efficient response to customer needs (Langley, 1986; Poist, 1986; Zinn and Grosse, 1990 in Carter, Pearson and Li, 1997). Consideration of logistic issues in strategy planning is especially important for international firms because the differences in business customs, inadequate transportation infrastructure, restrictive regulatory frameworks, and different levels of logistics services complicate overseas operations and make it much less controllable than in the domestic markets.

7.2.3.1 Product Supply

Fast moving consumer goods retailers require a large assortment of standardised, pre-packaged products and consistency in quality and supply. Due to high import duties, retailers tend to carry very few imported goods. The majority of products are supplied by suppliers within China. These suppliers can be Chinese manufacturers or multinational manufactories with factories in China, such as Procter and Gamble, Johnson and Johnson, Coca Cola and Nestlè.

Among the thirteen retailers that the author interviewed, five of them disclosed to the author the proportion of products that were produced and sourced within China. All products in Company I were produced and sourced within China. Company B only imported 5% of its products. Company D had 80% of its products produced and sourced within China. All three of them reported that they were happy with these proportions. For Company A, about 70% of products were supplied within China. On the other hand, Company C imported about 15-18% of its products. Both of these two retailers intended to decrease the proportion of imported goods for cost reasons.

According to Carter, Pearson and Li (1997), merchandise produced by local Chinese manufacturers tends to be of poor quality. Products often vary in size, weight, and quality from one production run to another. Packaging is also of low quality. Moreover, manufacturers lack marketing and selling techniques. They do not respond to the need of retailers or consumers. They appear passive in the relationships with retailers and indifferent to complaints. Delivery is unreliable because of production schedule problems and underdeveloped transportation infrastructures. The poor quality of products, lack of responsiveness to retailers and unreliability of supply make up the three most severe problems foreign retailers face in China. Carter, Pearson and Li (1997) further point out that there are other problems, including the unavailability of local suppliers, high prices from local suppliers and the lack of purchasing management skills of Chinese managers.

The present study supports some of Carter, Pearson and Li's (1997) claims. Foreign food retailers that the author interviewed reported that they experienced those problems that are claimed as the three most severe problems by Carter, Pearson and Li (1997). Nevertheless, the other problems that Carter, Pearson and Li suggested were hardly mentioned by the foreign retailers. In fact, on the contrary to their allegation that there is unavailability of local suppliers in China, the Vice President of Company B pointed out that there is a "good, wide variety of Chinese suppliers supplying different products". This opinion is also shared by the Chief Non-Food Purchasing Office of Company F. In addition, the General Manger of Company K also pointed out that "China market offers enough choices of products so that we can establish a very wide assortment".

Quality control is an area to which twelve out of the thirteen foreign food retailers interviewed paid special attention because of poor quality of product supply in the supply chain in China. These twelve retailers claimed that they had to maintain very tight control on the quality of products at the receiving department where products were first delivered by the suppliers. This is especially the case for fresh food because the concept of a cold and chilled chain was not common among suppliers in China. There was no cooling system and technology in some slaughter houses and not all meat delivery trucks had freezers or refrigerators installed. The General Manger of Company K stated that "it was difficult to find meat suppliers with cold and chilled chain facility". The Buying Manager of Company J similarly pointed out that there were

> "only a handful of suppliers who have cold and chilled chain facility and the companies who need these suppliers are mainly foreign-Sino joint venture companies in China".

Therefore, foreign food retailers had to give suppliers very strict requirements on the quality of meat and check the temperature of meat very carefully at the reception department. Any item that did not pass the quality test was rejected. The Chief Operating Officer of Company F mentioned that they also needed to spend time and be patient in explaining to suppliers their requirements and educate them about the importance of quality.

Another reason for poor quality of meat and frozen products is related to electricity supply and cost in China. According to the Executive Director, Finance, of Company E, electricity is very expensive to suppliers in China. Refrigeration system only became more commonly used when foreign retailers such as Carrefour and Wal-Mart entered China and demanded better quality of fresh and frozen food supply. Because of cost reason, some suppliers do not consistently maintain good refrigeration for their products. On the other hand, according to the General Manager of the distribution centre of Company L, power failure is serious in China. He stated as an example that it happened about once a month in their own frozen warehouse, although the failure usually lasted for a day each time when it happened. Serious electricity cuts in China are another reason for the difficulty of maintaining good quality supply of fresh and frozen food.

Packaging is another area that foreign retailers need to focus in more detail. Products sometimes did not arrive in the packaging specified by the retailers. The Chief Food Purchasing Officer of Company F pointed out that many suppliers in China do not understand the importance of issues such as combined truck loads, pricing, quality and packaging. He further reported that some Chinese suppliers did not categorise goods. For example, sometimes their suppliers packed goods of different size together. The Buying Manager of Company J, on the other hand, claimed that one of the biggest problems with product supply in China was that most Chinese suppliers had a very poor understanding of delivering brand messages through packaging. Consequently, retailers had to check the packaging of products very carefully when they arrived and reject any item that did not match their requirements.

On the other hand, suppliers' poor sensitivity to retailers' needs is another problem in product supply in China. Late delivery of products of an extent that is not negligible is experienced by all thirteen retailers interviewed. Although the poor transportation infrastructure in China is responsible for a large part of this problem, negligence in observing the need of retailers on the supplier side also contribute significantly to this problem. For example, the Manager of Supermarket Division of Company C alleged that some Chinese suppliers sometimes delivered less quantity than they ordered and they delivered the difference in their next delivery. The General Manager of the distribution centre of Company L also gave a very similar example,

> "sometimes, many times, they can't deliver the products we ordered...... and they do not provide us with information about the situation....... So, say, today we order 400 cases of products from the suppliers and expect them to deliver within the same day. We can hear nothing from them today, the next day and the day after. Then, suddenly they can send you 100 cases the day after that."

According to the Executive Director, Finance, of Company E, another example of suppliers' lack of sensitivity to retailers' needs is that some suppliers refused to deliver products if the retailers locate far away from the suppliers.

All thirteen retailers said that the problems related to product supply mentioned above do not disrupt their operations in China as long as they carried out careful monitor of the quality and packaging of products from suppliers. Furthermore, they believed that the standard of product supply is improving gradually as they continue to communicate to suppliers about their requirement and enforce it.

7.2.3.2 Transportation Infrastructure

According to all thirteen retailers interviewed, transportation of goods is normally dealt with by suppliers in China. Company A owned a few trucks for the transportation of goods from its distribution centre to its stores. The transportation of goods from supplier to distributor centre is still the suppliers' responsibility. Another two retailers, Company C and Company M, owned a few trucks to transport a small proportion of goods from suppliers to their own stores. For Company C, 99% of the transportation of goods was dealt with by suppliers and it only owned two trucks. For Company M, 70% of the transportation of goods was dealt with by suppliers. Company M was hoping that a larger proportion of goods would be transported by their suppliers and hence decrease the number of trucks they owned.

The transportation infrastructure in China is not well developed. This encumbers efficient physical movement of goods. A study by Carter, Pearson and Li (1997) shows that the most severe problems related to transportation service in China are the lack of delivery reliability of local carriers, inadequate transportation infrastructure, lack of carrier selection, excessive loading and unloading time at terminals, lack of cargo tracing services and the unavailability of transportation services. Other less severe problems include lack of transportation equipment, lack of inter-modal services, high tariffs from local carriers and the lack of transportation management skills of local Chinese managers.

The present research produces similar results to Carter, Pearson and Li's study, except that those problems related to long haul transportation do not appear to be of main concern to foreign food retailers in China. All thirteen retailers interviewed believed that transportation infrastructure in China is poor, which partly causes late delivery and stock-outs in their stores. The Vice President of a company closely associated with Company E described,

> "Logistics is one of China's weakest areas. The transportation infrastructure has not kept pace with the development of commerce and so we have this huge bottle neck in transportation of products."

Although their operations were not severely disrupted by transportation problems, all of the retailers interviewed claimed that the physical movement of goods in the supply chain from producers was not as efficient as in their host countries and therefore a lot of attention has to be given to the control of inventory level.

Delivery of goods between cities in China is difficult. The highway system is not comprehensive and it links only a few coastal cities. The Chief Operating Officer of Company F also pointed this out. Consequently, most distributors resort to railroads for long distance shipping. Nevertheless, the rail system is under tight control of the central government. Priority is often given to goods such as coal and agricultural products. Furthermore, rail freight is expensive. In addition to the base price of containers, firms are expected to pay for handling fees, delivery costs to and from the depot and other surcharges. Moreover, rail freight is extremely inflexible. Firms requiring less than one complete container receive very limited discount. Furthermore, booking on space has to be made several weeks, usually one month, in advance. In fact, the price of airfreight has been increasing significantly. Although airfreight remains competitive for many foreign firms, it is constricted by the volume limitations of individual aircraft and a shortfall in overall supply. With continuous increase in the cost of using a plane, joint venture road haulage tends to be more attractive. Delivery using road haulage between Beijing and Shanghai takes two to three days. It is available at shorter notice and breakage rate tends to be lower.

The Director of Company A pointed out that many products sold in retail stores were not produced locally. They could be produced in places that are very far away from the store in which they are sold. In this case, they have to be transported for long distance from manufacturers to retailers through a varied number of intermediaries. Because of the difficulty in delivery between cities as mentioned in the last paragraph, together with poor coordination between different intermediaries, the last tier of intermediaries may not be able to deliver the products required by retailers because of out-of-stock at some earlier tiers in the distribution channel.

Another issue is that the transportation industry in China is largely controlled by the army, according to the President of Company D. He claimed,

> "the army is heavily involved in the transportation business. I am not saying that they have the monopoly on the transportation, but they are very heavily involved in the industry. So, they operate the transport to a large extent. There are other modern companies coming in here but the transportation industry is still extensively army reserved."

Some foreign firms such as Denmark's Santa Fe, Germany's Schenker, Britain's Inchcape and US-Japanese Crown Pacific have set up nationwide trucking networks with some Chinese players in the form of joint ventures in an attempt to alleviate the physical distribution problem. There is no doubt that the involvement of these foreign firms means more comprehensive national coverage with competitive rates and reasonable efficiency. These joint ventures' edge lies on their ability to organise many different clients, each of which wants to move merely a few cubic metres of freight, but each of which is willing to pay a premium for quality service and just-in-time delivery. However, owing to the dominance of the army in the transportation industry as described by the President of Company D above, modernisation of the transportation industry is a very slow process, which encumbers the efficient distribution of goods throughout the distribution channel.

Traffic congestion within cities also hinders the efficient movement of goods. For example, delivery of goods in Shanghai is horrendous. According to the Economist Intelligence Unit (1996a), the Shanghai municipality auctions separate delivery licenses for even and odd days in order to alleviate traffic congestion. These licenses cost about Rmb 20 000 (US$2 400) per truck. The number of licenses that each company is permitted to purchase depends on the firm's paid-in capital. To alleviate the traffic congestion further, the municipality only allows 5% of a company's delivery fleet to obtain passes for travel within the inner ringroad and the travel time is limited to from 8pm to 8am. These passes allow delivery on certain inner ringroad streets, whereas other streets are either completely off-limits, temporarily closed for construction or require an additional pass. What further complicates the delivery problem is that there are always regulatory changes. When conflicts arise, there is no clear direction on what determines the overriding regulation.

According to the General Manager of Company K and the General Manager of the distribution centre of Company L, there are also similar restrictions on commercial transportation in Beijing. Commercial transport in Beijing is limited to certain hours and big trucks are not allowed on ring roads outside the specified hours.

All of the above factors make transportation of products from suppliers to retailers difficult. Consequently, as mentioned earlier, foreign food retailers had to adjust their stock level very carefully, especially during festival periods. In case of supermarket retailers, as suggested by the Buying Manager of Company J, this may mean that they will need distribution centres in order to keep up the stock level to solve the problems of unreliable delivery or stock-outs caused by the poor transportation infrastructure. The Executive Director, Finance, of Company E, also disclosed that they would probably have a distribution centre in the near future in order to avoid stock-outs. Because of the distribution centre, he further mentioned, they would need to own two to three trucks to transport goods between their distribution centre and their stores. On the other hand, retailers may need to 'work around things' in China. Due to the underdeveloped distribution and transportation infrastructure, the president of Company D reported that he sometimes found transporting products with up to five tricycles was more economical and efficient than using trucks. He claimed that this did not make sense to him when he first worked in China but he was convinced at a later stage.

7.2.3.3 Level of Computerisation

The employment of electronic point-of-sales (EPOS) and electronic data interchange (EDI) in the distribution channel enables manufacturers to obtain accurate market information directly from retailers and allows retailers to track inventory requirements, reducing the need for the cushion that wholesalers provide. However, in China, the level of computerisation is still low. The utilisation of computer and information technology in logistics is limited.

EPOS and a barcode system were introduced into China during the early 1990s. Since then, the interest of domestic retailers in adopting such technology has been increasing. An EPOS system was first introduced into Guangdong and Shanghai. During the two-year period of 1992 and 1993 more than 40 supermarkets and large stores in China were known to have introduced EPOS (Euromonitor, 1995). Commentators claimed that these stores doubled or trebled their profits as a result of the introduction of the technology (Euromonitor, 1995).

Barcode has become quite widely used nowadays. Nevertheless, according to some respondents in the author's fieldwork, there is sometimes confusion over the codes being used. The president of Company D described the situation in China as similar to that when barcode was first introduced in Europe. There is sometimes overlap of barcodes for different products. Both the president of Company D and the Vice General Manager of Company M claimed that this problem is quite common. Sometimes, the barcode for the same product is different, which causes much confusion and inconvenience for repeat orders of the product. The General Manager of the distribution centre of Company L provided this example,

> "There is a noodle manufacturer. They have four factories producing the same product, let's call it A. This manufacturer gives A from different factory a different barcode. Sometimes, they supply us A from factory 1. Sometimes, they supply us A from factory 4. So on and so forth. As a result, we have got four different barcodes registered in our system. However, we do not know which batch is from which factory. The situation, hence, is very confusing when it comes to making a repeat order. Once, when the level of stock of product A ran low, we looked at the barcode of that batch and we called up the manufacturer to order more of that product. However, they told us that they didn't have that product. It took both them and us quite a while to realise that the factory we were talking about was no. 1 and it was factory no. 4 that

> supplied us the batch of product A that was almost being sold out. So, at the end, they got factory no. 4 to send us more of that product. This is a very confusing situation. Another problem with this confusion of barcode is that at the beginning, we stick with the first barcode of product A that we received. After some time, when we reviewed product performance, we found that there was no sales for three products. It also took us some time again to figure out that that three 'products' was actually product A, only that they had a different barcode. So, the whole situation can be quite confusing."

The confusion of barcode does not only occur with Chinese suppliers. Even some foreign-Sino joint venture manufacturers make mistakes sometime, as pointed out by the President of Company D and the General Manager of the distribution Centre of Company L. In order to resolve the confusion, retailers have to double check the barcodes when the merchandise comes into the store and if needed, they have to re-barcode themselves. The Executive Director, Finance, of Company E, said that they also helped teaching some suppliers, who originally did not have the knowledge, how to make barcode.

On the retailer side, foreign food retailers possess the knowledge and resources to implement the latest computer technology in inventory management and logistics activities. However, due to a number of reasons, which are discussed later, there is no implementation of EDI system in China. Disregarding the EDI system, nine of the thirteen retailers claimed that they were fully computerised. They used an EPOS system and scanners. They made use of the EPOS data to monitor the performance of their stores and inventory level. Computer technology is utilised wherever possible. Five of these nine retailers had distribution centres. In the case of these retailers, their distribution centres were also fully computerised and there was automatic computerised replenishment system between their stores and their distribution centres.

Company C and Company H reported that they were only partly computerised. Inventory management in their companies was partly carried out manually and partly using a computer system. Company A and Company I described their level of computerisation to be very low. The General Manager of Company I explained that they wanted to open their first store as quickly as possible and keep costs at the minimum. Moreover, the level of computerisation throughout the industry was low at the moment. Therefore, they decided to go without much reliance on information technology at the commencement of their business in China, although he believed that their level of computerisation would gradually increase. The Director of Company A also similarly claimed that their company in China was slowly moving in the direction of full computerisation, because information technology would no doubt increase efficiency and profit. He also believed that the whole industry would improve in this aspect in due course for the same reason.

As stressed by the Chief Operating Officer of Company F, information technology is of paramount importance to the efficiency of a distributor. Company F believed that it is so important that they had a special department set up in Europe to research and develop the best information technology for their company. The lack of EDI system, together with the lack of communication infrastructure, makes order processing and inventory management in China more difficult tasks than in many other more developed places. Manual documentation operations lead to slow order processing. The deficiency of an efficient and effective order processing and inventory control means more difficult management of a huge variety and volume of merchandise. It also makes the track keeping of the information of products being sold and control of stock-outs situation difficult.

Some foreign food retailers have tried to convince their suppliers to adopt more information and computer technology. According to the General Manager of Company K and the General Manager of the distribution centre of Company L, some small Chinese suppliers did not even have fax machines, primarily because of lack of financial resources. The Executive Director, Finance, of Company E added that because of their lack of capital, getting suppliers to computerise became very difficult and there was not much that their company could do. He pointed out that subsidising their suppliers' process of computerisation was no doubt an option but it did not make sense for the time being. Developing their own chain in China at the moment appeared to be a better investment. Apart from the need of financial resources, according to the Buying Manager of Company J, educating suppliers about the benefits that computerisation will bring is also essential. Improving financial status and getting educated take time. Consequently, "it will take a long time for the Chinese suppliers to computerise", said the Buying Manager of Company J.

In fact, even multinational manufacturers in China are unwilling to bring in EDI technology. The General Manager of Company K stated that these multinational manufacturers were reluctant to invest in this technology in China because the number and scale of their buyers in China who possess the necessary resources to invest and implement the same system did not justify the cost of investment. He further revealed,

> "we have talked with Proctor and Gamble to set the EDI system up, but they have their difficulty. They won't introduce it without the possibility of making a profit out of it. I don't know what a company would be able to do if P&G can't do it.

The General Manager of the distribution centre of Company L also suggested that the unreliable electricity supply in China could hinder the efficient utilisation of computer systems.

Based on the above discussion on product supply, transportation infrastructure and level of computerisation in China, a few implications are presented as follows. Suppliers directly affect a retailer through their product quality and on-time delivery performance. Simultaneously, they also have indirect effects. Barriers in the areas of infrastructure, transportation services, inventory control and warehousing services result in long transit time, high transportation costs and high inventory levels. All of these problems are especially pertinent to food retailing because food has a characteristic of high perishability, especially fresh food. The in-store availability of merchandise depends heavily on the timely delivery from suppliers. A food retailer will be able to reduce cost on storage space for inventory if they can manage to create a 'time-definite supply-chain management'. In other words, the severity of these problems can be decreased by suppliers who can ensure high quality of services. Although all thirteen retailers interviewed claimed that the logistic related problems discussed earlier did not have significant negative impact on their operations in China, those problems do require adjustment to some of the retailers' practices. In fact, as demonstrated in the discussion earlier, adjustments were witnessed. The transformation of Chinese suppliers and the emergence of a computerised era in the distribution industry in China will only come gradually and is heavily dependent on improvements in infrastructure.

7.2.4 Relationships between Foreign Food Retailers Interviewed and their Suppliers

Supply chain relationship management is a crucial element in retailing because retailers' relationships with their suppliers can affect the quality of merchandise they offer to the consumers. When a foreign retailer enters China, one important issue that they face is sourcing. Sourcing from indigenous suppliers is inevitable. The Chinese business culture is unique in some sense. Trust[4] is a very important element in

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[4] Morgan and Hunt (1994) conceptualise trust as existing when one party is confident in an exchange partner's reliability and integrity. In operational terms, norms of exchange in the wholesaler-retailer dyads are represented by the extent to which the wholesaler and retailer feel confident that the other party will attach to channel decisions and agreements, and by openness and sharing of information by the two parties. The presence of good personal relations and reciprocal confidence is perceived as important elements of trustful norms of exchange (Young and Wilkinson, 1989). Economic performance of the channel is demonstrated by Reve (1981) to be positively related to the level of trustful norms of exchange within the channel. Williamson (1975) also holds similar view. He maintains that transaction costs will reduce when exchanges take place in an atmosphere of trust and commonality of purpose because of diminished possibility of opportunistic behaviour. If people were completely trustworthy, it would become possible to reach an agreement that the parties could rely on, even with the existence of bounded rationality (Dixon and Wilkinson, 1986).

In fact, interorganisational exchange such as the one between buyers and sellers is governed, to a significant extent, by social control mechanisms, which are the traditions and values, inherent in the channel. Channel itself is an organisation arising from the network of trading relationships that have established over time. Consequently, a channel culture emerges. The shared values that constitute this culture generate trust that reduces uncertainty. The enduring dyadic relationship is also manifested by mutual adjustment and working rules that provide a means of co-ordination (Dixon and Wilkinson, 1986).

Trust also influences commitment. This causality is explained by social exchange theory through the principle of generalised reciprocity, which maintains that

> "mistrust breeds mistrust and as such would also serve to decrease commitment in the relationship and shift the transaction to one of more direct short-term exchanges" (McDonald, 1981:834).

A retailer's trust in its supplier affects the commitment of the retailer in the following three ways. First, it reduces the perception of risk related to opportunistic behaviours by the suppliers. Secondly, it increases the confidence of the retailer that short-term inequities will be resolved over a long period. Finally, it reduces the transaction costs in an exchange relationship.

Chinese business dealings (Redding, 1990). This implies that foreign retailers are confronted with a different context in which business transactions are carried out. The following investigates, from the viewpoint of the foreign retailers, the relationship of foreign retailers in China with their suppliers.

7.2.4.1 Comparison between Multinational Suppliers in China and Indigenous Suppliers

In general, the foreign retailers interviewed held the opinion that multinational suppliers in China, in comparison to indigenous suppliers, were more reliable, had better quality control and marketing and offered broader range of assortment. They also claimed that multinational suppliers had a better-defined set of standards and trading policy, which then carried different implications to retailers.

The Buying Manager of Company J stated that,

> "With international suppliers, price-wise, it's more convenient when you are negotiating. They've got very good structure on it, for example, what price for what. Obviously you have to negotiate to see what level you can get to but there is a general structure. They are not just coming in and just negotiating and trying to knock off a bit here and knock off a bit there. Furthermore, they are more willing to look at long-term basis. They will support you long term. They are willing to look at longer term. Now, that support might be through promotion, product range or merchandising, different fees for different support, advertising, and so on and so forth. Some of the local suppliers, they don't have the money. They don't have the structure. They don't have the experience either to do that kind of support. A lot of them (local suppliers), they are obviously under pressure, well of course everyone is under pressure, but they have to see 'what can I sell this month', so what they do is: take this, take this, take this, do a promotion hoping to boost sales for that month. But, it might not be the best time in a year or might not be the right product to do the promotion. And then they basically can't see how there can be a long-term relationship between them and a retailer, how they can have a cooperative relationship with a retailer. This is actually the most frustrating thing about being a buyer in China. If you look at supply chain in China, it's very primitive, and the relationships between buyers, suppliers and manufacturers are very primitive too. A lot of suppliers of course don't look further than next month, and they don't look at the whole brand/the development nor at what retailers are doing in the market. So, basically, they are kind of like shooting themselves at the throat in the long term. They might get pretty well sales this month but long term, they need quite a development."

The General Manager of Company K also shared a view that resembles the second point of the Buying Manager of Company J. He reported that establishing "working relationship" with indigenous suppliers is difficult because they did not know how establishing a relationship would benefit them in the long run.

Contrasting the above opinion, both the Chief Executive Officer of Company F and the General Manager of Company I alleged that because of a well establish structure of multinational suppliers, dealing with them could be quite difficult sometimes because they had very firm policy about prices and requirements on how and where to display their products in the retailers' stores. These two foreign retailers found that, in contrast, they could more easily influence indigenous suppliers in terms of price and product policy.

Although there are differences between multinational suppliers and indigenous suppliers in terms of reliability, quality control, marketing and merchandising, the Vice President of Company B claimed that the indigenous suppliers were "picking up very quickly".

7.2.4.2 Preference on the Type of Suppliers

Six of the thirteen retailers interviewed did not respond on their preference on the type of suppliers. They are Companies A, C, H, I, L, and M. Company E did not directly respond on this issue but the Executive Director, Finance, pointed out that the products they carried that were from the big multinational manufacturers did not make up a great proportion. In approximation, at the time of interview, only about 2000 out of 14 000 SKU that they carried in one of their stores were from the "big boys". He further indicated that they did not have any inclination towards multinational suppliers.

Five retailers, Company B, D, F, G and K, stated that they did not have any preference between the multinational suppliers and indigenous suppliers. They said that which supplier they chose to deal with depends on the purchase terms, quality and services of the product concerned. The President of Company D further emphasised that their preference was, instead of on either multinational or indigenous suppliers, dependent on the size and progressiveness of the suppliers. They in general preferred larger or "more progressive" suppliers because they found that small companies usually had a slower pace in modernising their management operations. The Assistant General Manager of Company H and the Vice General Manager of Company M had a similar preference on larger suppliers, regardless whether they were multinational or indigenous. However, the reason for their preference is slightly different to that given by the President of Company D. Both respondents from Company H and Company M stated that suppliers of larger scale usually supplied higher quality products. The Vice General Manager of Company M disclosed that they had a company rule stipulating that they should not buy from the medium to small-scale suppliers that located outside the district where their store was situated. Instead, they should buy from the manufacturers or wholesalers who were of a larger scale and were situated inside Beijing city. He claimed that by doing so their product risk was reduced.

Only one retailer, Company J, preferred multinational suppliers to indigenous suppliers, for the reason that negotiating with multinational ones was more convenient as they had better structure and multinational suppliers had a longer term perspective. These reasons are discussed in details in an earlier paragraph.

7.2.4.3 Choosing Suppliers

When asked how they chose suppliers, response was obtained from nine companies: Companies A, B, D, F, H, J, K, L and M. In general, all of these nine companies reported that they used the same methods to choose suppliers in China as in any other countries. In other words, they follow the same rule in choosing suppliers. They chose suppliers based on the merchandise they wanted. In other words, they first established a list of assortment they wanted to carry. Then, they looked at which suppliers could provide those merchandise in the conditions they wanted. Obviously, the conditions they mentioned that they considered were price, quality and services.

A number of interesting points were revealed during the discussion of this topic. First, there are fundamental differences in the concept of choosing suppliers between foreign retailers and most traditional indigenous retailers, which has implications for the trading relationship between foreign retailers and indigenous suppliers. According to the Vice General Manager of Company M,

> "many local retailers in Beijing think about suppliers first because they even think about what kind of products they should carry in their stores. Their whole concept is to use suppliers to fill their stores, whereas we use merchandise that we want to fill our stores. We decide on assortment first and then choose suppliers who can provide those assortment to us with terms that suit us. They decide on the suppliers first. Then they will use whatever merchandises the suppliers carry to fill their stores. This is a very common Chinese practise in the distribution channel here. And this has implication on our dealings with some Chinese suppliers, who are used to this concept and practice.
>
> "We have tried to transfer and explain our concept to them. It was a shame that most of them just couldn't grasp the essence of our concept. They just couldn't understand what we mean by 'what merchandise do we need to fill this store?' For Chinese retailers, for example, if they are a cup retailer, what they would do is to find some cup suppliers/manufacturers and put their products in store and sell them. In other words, they are more like just a means to provide a place for manufacturers/wholesalers to sell their products. For us, we think about our whole retail concept. If we are a cup retailer, we will think about a cup retail concept and formula and hence decide on what cups we want to sell. Only then will we look for the right suppliers. We tried to educate them about our concept repeatedly but all they can achieve so far is about, say, 5% of what we want, in terms of conforming to our distribution concept.
>
> "Because of this difference, there is a discrepancy between our desired product policy and their product policy. They usually expect that we will let them be responsible for a department/section in our store and let them fill the department/section with their merchandise as they see fit. Because of this, we need to put some effort in dealing with them."

The second point is that some respondents believed that local suppliers were more willing to trade with foreign retailers than with local ones because foreign retailers had better reputation in terms of paying on time. Both the Vice President of Company B and the President of Company D claimed that there were many local suppliers approach them everyday hoping that they could be their suppliers. Their belief and claim could well be plausible, because, according to the Executive

Director, Finance, of Company E, most Chinese retailers in China have serious financial problems. The money that they are liable to pay their suppliers usually becomes bad debt. The Executive Director, Finance, of Company E had been working on the supply side in the distribution channel and had had very close contacts with a huge number of Chinese retailers in China. He witnessed that these Chinese retailers seriously lacked financial capital. However, they kept expanding. The trick was that they expanded on the suppliers' credit terms. In other words, they used short-term credits from suppliers to support their fixed asset, which is a long term investment. What had worsened the problem was that they did not possess the relevant retail know-how to make their business take off. Subsequently, they had to go bankrupt. This in turn means that many of their suppliers could never recover the debt.

Thirdly, Company A stated that they used local people to handle Chinese suppliers because local staff was more familiar with the norm, practice and culture of Chinese suppliers. They were therefore also in a better position to communicate with Chinese suppliers, especially in cases when Company A had concept and practice that was different to that of the Chinese suppliers. This point has further implication on the establishment of relationships in the channel in China, which is discussed later.

7.2.4.4 Terms of Purchases

Two retailers were not willing to discuss their terms of purchases with the author. Based on the discussion with the other eleven retailers, credit terms that foreign food retailers obtained in China are not significantly different to those they obtained elsewhere in the world. The Chief Non-Food Purchasing Officer of Company F stated that "the norm (in China) is the same as in Europe". The General Manager of Company K shared the same opinion. The General Manger of Company I claimed that "credit terms (in China) is similar to that everywhere else in the world". The Director of Company A and the General Manager of the distribution centre of Company L made the same remark.

As disclosed to the author, the credit terms received by most of the foreign retailers in China range from immediate cash payment, five to seven days, 30, 50, 60 or up to 90 days. Credit terms for food are very short, usually up to 10 days. Purchases of fresh food made at markets usually require immediate cash payment. The credit terms for other products are longer. The only significant deviation to this 'norm' that the author found is that Company C obtained 30 days credit for some fresh food products, according to the Manager of its Supermarket Division. He stressed that 30 days credit for fresh food was a very good credit term according the industry standard. He further pointed out that even if they could not get 30 days, they could easily obtain 15 days. When the author posted a follow up question to this manager about how or why they could obtain such a favourable term, this manager refused to discuss further because he claimed that this was company secret.

In general, the exact terms of purchase that foreign food retailers in China obtained depends on the products, prices, confidence of suppliers in the retailer's ability to clear the credit and the balance of power between the suppliers and the retailers. Apart from Company C, the Chief Non-Food Purchasing Officer of Company F and the President of Company D specifically expressed that they believed the terms that they were obtaining in China were quite favourable.

7.2.4.5 Information Sharing between Vertical Channel Members in China

No information on this issue was obtained from Companies A, H, I and M. Out of the other nine retailers interviewed, one retailer, Company D, claimed that they did not share any information with their suppliers in China. The other eight retailers reported that they shared with their suppliers sales figures and other performance related information of the products that were supplied by them. These retailers had to share this information with their supplier so that their suppliers could make better forecast and hence preparation for the kind and quantity of the products that the retailers needed. For company F and Company K, there was another reason for the sharing of that information. According to the Chief Non-Food Purchasing Officer of Company F and the General Manager of Company K, they also hoped that by sharing this information they could have better cooperation with the suppliers in terms of increasing the performance of the products. The Chief Non-Food Purchasing Officer of Company F further added that in exchange they also needed information from suppliers on the overall marketing information of the products so that Company F could work out their own position in the market. Company F also gave their suppliers information about their new store opening so that again their suppliers could better prepare the inventory Company F would need. On the other hand, the General Manager of the distribution centre of Company M claimed that sometimes they and their suppliers would discuss and share information of new products in the market.

According to the above discussion, information sharing between foreign retailers and their suppliers in China is only done to a certain extent. This implies that there is only very little, if any, trusting and committing relationship established between foreign food retailers and their suppliers in China (this is investigated further in a later section). Cooperative activities such as joint management of products are rare. As the General Manager of Company K remarked, product category management had only just started in China. It is in its very infancy. Other cooperative activities are discussed below.

7.2.4.6 Joint Product Development with Manufacturers in China

Three retailers, Company B, F and G, expressed that they sometimes had joint product development with suppliers in China.

Another three retailers, Company I, K and M claimed that they were seriously considering joint product development with suppliers. Nevertheless, the General Manager of Company I pointed out that they might encounter difficulty in finding a manufacturer who could produce for Company I in the quality, quantity and time they required. This point was also emphasised by the Executive Director, Finance, of Company E, who stated that many manufacturers in China were very cautious in expansion and opening of new product lines because most of these manufacturers were losing money and they therefore were more keen to sort out their financial problem and credit terms with buyers before they delved into other issues. The Vice General Manager of Company M acknowledged this same difficulty but they stressed that they would like the manufacturers to grow with Company M in China, although achieving this would take a long time.

Four companies: A, E, J and L, said that they did not have such activity with suppliers nor were they trying to do it at the time of interview, because of scale problems for the time being. All of these four retailers maintained that the investment in joint product development with manufacturers would only be justifiable when the products to be developed were of large enough volumes. Nevertheless, the scale of their operation in China at the moment was not big enough to absorb that kind of volume. Consequently, they would not look too much into joint product development at the moment until the situation changed. In addition, the Buying Manager of Company J went further to share his opinion on selling own brand product. He alleged that it was not the right time to manufacture and sell their own brand products in China at the time of interview, because selling own brand products would only be profitable when there was high awareness of their company brand. He stated that they had not achieved that yet and brand awareness would take a long time to build. The Director of Company A also remarked on the issue of selling own brand products in China. His discussion revealed some other difficulties related to this issue,

> "...we sell our own brand products in many other countries. We have them manufactured in places such as Thailand and China. However, we do not sell them in China. The first reason is that we do not handle import ourselves in China because of the regulatory situation here. Of course we can use import agent, but anyway, import involves high import cost. Then, there is the labelling requirement. The labelling requirement in China is much stricter than in a lot of other countries. Give you a very simple and straight-forward example. If we have to sell our own brand products in China, one requirement is that all the labelling of those products must be in simplified Chinese characters. Our own brand products are sold in Australia in large volume. Our operation scale in China does not justify making a separate batch or new packaging design just for our operation here, regarding whether we are talking about manufacturing them here or in Thailand."

No information on the issue of joint product development was provided by the other three retailers, which are Companies C, D, and H.

7.2.4.7 Importance of Relationship in the Distribution Channel

From the above discussion, the interactions between foreign retailers and their suppliers in China at the moment appear to remain largely transactional. There has not yet been a committed and trusting relationship established. This is not surprising when the modernisation of distribution in China is at its infancy, because such relationship requires a long time and effort to nurture and requires a good match between the retailers and the suppliers. The Buying Manager of Company J stated that,

> "We have tried to developed cooperative and long term oriented relationship with suppliers but it is difficult with some of them in China. Generally, most people in the supply chain in China have no exposure to the idea of service and how you increase sales and market share together in the long term. They have kind of just started to see it now, but the management experience/exposure is not up to a critical level yet. Moreover, they change people quite often. Some local suppliers may have started to understand this 'new' concept and want to develop such relationships with retailers but they may not have the money to support a long term development. So it is difficult for them. Nevertheless, we do work with some local suppliers in terms of promotion, I mean, you try to give them good space and equal support, although they tend not to have much money to spend."

The Managing Director of Company C shared a similar view. The General Manager of the distribution centre of Company L, on the other hand, made a similar point about the problem of the frequent change of personnel on the supply side.

> "We have a so-so relationship with suppliers here in terms of trust and long term relationship. We try to keep a long term relationship with them. We do the same in our home country. But there is one problem here. The person in charge on the manufacturer side changes very frequently. The personnel in one of our manufacturers with whom we have established relationship with has left the company. The person who succeeded the job did not know the practices of our deals. The worst thing is that the original personnel did not write any reports. So, his successor did not know a thing about the relationship between us. This is the problem when the personnel changes frequently."

Moreover, the lack of a committed and trusting relationship between foreign retailers and their suppliers in China does not necessarily imply that foreign retailers had no intention to build up such relationships. In fact, many respondents believed that developing a trusting and long term oriented relationship is beneficial in the long run and they endeavoured to do so.

The Buying Manager of Company J pointed out that,

> "Having long term relationship with suppliers is very important if you are a growing retailer because when you grow, you need suppliers' support, in financial term as well as in terms of producing the product you need. If you don't have that support, you can't be able to run a successful retail business. In other words, if you don't have that kind of relationship with your suppliers, it's a real problem, you will struggle."

The Manager of Supermarket Division of Company C also emphasised that they were committed to the development of long term cooperating relationship with suppliers.

> "We develop suppliers with non-stop communication. We help them to make better use of capital investment and to carry out value added activity. We encourage them to cooperate with us. We want to help our suppliers to develop in the same phase as us. Communication is very important. We want to build a relationship in a long term basis. But whether establishing such relationship with suppliers is successful or not depends on whether the supplier has the same goal. If not, if we can't cooperate and we have to change suppliers."

In the same vein, the Chief Executive Officer of Company F stressed that a retailer

> "has to have trusting long term relationship with their suppliers so that information can be shared among the supply chain partners, which is very crucial for the optimization of the business."

The Vice-President of Company B stated that they always do their best in having their suppliers grow with Company B. Similarly, the Chief Non-Food Purchasing Officer of Company F also deeply believed in the importance of long term relationship with suppliers.

> "We have very good relationship with our suppliers. We count on them. Basically we are facing the customers with the back support of suppliers. We need them to back me up and help me to face our customers. I intend to build up a very professional long term win-win relationship with suppliers."

In fact, a number of studies in the west have also shown that both buyers and sellers receive more tangible benefits when they have established a trusting relationships than when they merely attempt to exploit their power over one another (Kumar, 1996). Trust helps supplier-buyer relationships to realise their full potential. When both sides trust each other, they are able to share confidential information, to invest in understanding each other's business, and to customise their information systems or dedicate people and resources to serve each other better. Ellram's (1995) study on buyer-seller relationship shows similar results. He found that the two primary reasons buyers attempt to build up a relationship with their suppliers are to obtain a better price for the purchased items and to secure a reliable source. Source reliability comprises the idea of having an ensured source of supply in times of scarcity, a source that will live up to its commitments and promises, and one that demonstrates overall dependability. The ability to influence suppliers' quality and the desire to influence supplier delivery schedules were found to be the two next most important factors that induce a buyer to enter into a relationship. His results mirror the traditional emphasis on price, quality and delivery in supplier selection decision. Furthermore, his study indicates that trust is a very important element to the success of the relationship.

In the case of retailing, the same principle applies. Price, quality and delivery of merchandise are the most important factors that influence the success of retailers. Moreover, the consumer's taste changes very quickly. Therefore, if a supplier and a retailer work very closely with each other, both will be more capable to cope with these changes.

In China, trust is the most important element for building up a network, translated as *guanxi* in Chinese, which in turn is the most influential factor to the success of doing business there. Network has been recognised as the dominant form of transactional governance in China since long before the concept has been given vast attention by Western scholars (Davies, Leung, Luk and Wong, 1995). China is a country in which the maintenance of harmony is perceived to be of paramount importance. Sellers would do their utmost to avoid embarrassing customers (Luo, 1995 in Davies, Leung, Luk and Wong, 1995). Foreign retailers should observe this culture and endeavour to establish harmonious and trusting relationship with their suppliers in order to obtain cooperation with their suppliers in China.

Despite the acknowledgement of the importance of long term oriented relationship discussed above, one must note that power struggle and conflicts between vertical members of the supply chain still exist. Trust is not all encompassing (Kumar, 1996). One may trust the partner on some issues but not on others. Buyers and sellers are always aware of which information, skills and technologies are to be protected and which are to be shared. Competition between retailers and suppliers originates from the decision on the rate the profit caused by a transaction is divided. The party with the stronger bargaining power will have the bigger share of the 'pie'. Bargaining power can be affected by factors such as the degree to which one party relies on the other, the number of alternatives available for each party to choose, the scale of production or operation, the financial condition, the capacity to resist risk and bargaining skill (Zhuang, 1998). In other words, channel members are constantly and simultaneously confronted with both the need of struggling for power and the need of developing long term relationships with their partners, although there has been an increasing emphasis on the "trust game", or the so called "win-win situation" (Kumar, 1996:105). This point is illustrated in the Chief Food Purchasing Officer of Company F's expression.

> "What we try is to get more profit by having low prices from the wholesaler/supplier. Otherwise it makes no sense from the costs point of view. Simultaneously, and normally, we stay with our suppliers. We try to build up cooperation with, and educate our suppliers. This is what we've been doing from the beginning of our business here. We try to educate them and tell them what we do, what our customers need, how we serve these customers, who are also their ultimate customers. In other words, we are serving their customers. So, we try to educate them how both of us can serve our common customers together."

The inevitability of co-existence of power struggle and the need to build up long term relationships among vertical channel members is even more prominently shown in the statements made by the President of Company D when discussing about their bargaining power over their suppliers,

> "I think we have a very high reputation among the suppliers because we are a world known business and we know what we are doing and we do pay on time. We need to grow our company and with the grow of the company, we should get bigger and bigger bargaining power. But I think we have already got a very high reputation in the market. And we have brought differences to the market. We set new standards. Many people have copied our system and

> standards already. So, we have bargaining power to a certain extent here already. We **negotiate very hard** but then we pay on time and honour what we agree to do. So, as recognized, we are not easy to deal with but once you have got subscribed, your company will be safe with us. We are giving our suppliers the opportunity to increase their market share. If they want to grow too, we will develop business with them. This is what we want to do. So, they like to deal with, I would say, modern distribution company like us. They want us to expand as well. So, there are two sides of the game: you need the bargaining power but you also need to build a good cooperative relationship within the buyer-seller dyad because of the inter-dependence."

Therefore, both power struggle and commitment to long term relationships should be considered at the same time, instead of being treated as two mutually exclusive elements, in the study of channel behaviour, if a comprehensive understanding is to be obtained.

7.2.5 Supply chain management as a competitive advantage

Supply chain management is a means through which competitive advantages can be developed and sustained (Ellis and Kelley, 1992; Skytte, 1992). According to Day and Wensley (1988), there are three sequential elements of competitive advantage in the supply chain. First, there needs to be a source of advantage. There are two types of source: superior skills and superior resources. Superior skills are the distinctive capabilities of personnel. Superior resources are the tangible requirement for advantages. These sources of advantages can then be converted into the second element: positional advantage. In the supply chain, positional advantages are recognised as superior customer value and lower relative costs. The former is obtained when some value-adding activities are created and performed in a way that results in perceived superiority along dimensions that are valued by customers. The latter means performing the majority of activities at a lower cost than that of competitors when offering a parity product or service. When these positional advantages are combined, they can be transformed into performance outcomes, which is the third sequential element. Examples of performance outcomes are customer satisfaction, customer loyalty, market share and relative profits. In order to sustain competitive effectiveness, the key factors that have the greatest leverage on positional advantages and performance outcomes must be identified.

For a retailer, achieving low cost structure and offering superior value-adding activities are not possible without appropriate management of the distribution channel right from the manufacturers through to the middlemen and finally to the retailers themselves, because the upstream supply chain significantly affects the costs and services of the "products" that retailers offer to the end users. According to Kumar (1996), when retailers and suppliers work together as partners, they can provide consumers with products with the greatest value at the lowest possible costs. Proper management of the channel relationship accelerates the deployment of complicated systems such as electronic date interchange and efficient-consumer-response systems that enable manufacturers to monitor sales in stores and to produce and ship their merchandise in response to actual consumer demand, which in turn provide retailers with competitive advantage. This point is well demonstrated by the remarks of the General Manager of company K,

> "We have to form a partnership with our suppliers. **At the end, we are selling their products** so we have to find a way to get their products consumed, so you have to work together with your suppliers so that the products can be well consumed. First of all, you have to exchange information, such as market share of each product, promotional activities and result of promotional activities. Results of promotional activities can be things such as does it work, does it work in this way, does it work in that way, etc. You have to make promotional plans together for the future. Next stage, you have to work with your suppliers in fine-tuning the assortment. This is called product category management, which is at a very initial stage in China but local people are starting to pick up and people are starting to get interested in it. Then you have the fine-tuning of the logistics, and they call for a physical human response, because in China, there is the missing technological network......"

As mentioned in the last paragraph, a retailer must possess superior skills and resources to give rise to competitive advantages in channel management. A large part of superior skills of a retailer derives from its personnel. If its personnel are able to handle interactions with partners in the supply chain in a better way than their competing counterparts, the retailer will possess certain kind of superior skills. A supply chain is considered as interorganisational collectives of institutions that are simultaneously pursuing self-interest and collective goals (Stern and Reve, 1980). It is made up of many different buyer-seller dyads. Within a dyad, there is internal economy and internal polity. The transactional form linking dyad members represents the economic structure of the dyad. The means by which the decision mechanisms used to determine the functions and the terms of trade defines the economic process. As discussed before, there is a power-dependence relation between the buyer and the seller in a dyad. The pattern of this relation forms the internal socio-political structure. The extent and pattern of cooperation and conflicts forms is described as the internal socio-political processes within the dyad. These structures and processes affect the competitive effectiveness and the economic performance in a dyad. Capable personnel should be able to manipulate these structures and processes and interorganisational relations for the good of their retailing companies.

In order to manipulate those interorganisational relations, the personnel have also to be aware of the fact that business transactions are never one-off deal. As discussed earlier, when transactions are carried out with the same partner for a period of time, trust between the partners can be established. When transactions are carried out in internal markets where long term relationship exists and transactions are planned and administered, there is more efficient management of information, a decrease in transactional costs, the synergy of combining complementary operations and reduced uncertainty of operations (Arndt, 1979). Consequently, the personnel should also pay attention to the dynamic nature and development of each interaction with its supply chain partner. Simultaneously, retail personnel should also note that the environment in which buyer-seller interactions are embedded is also constituted by the actions of other actors in the channel. In other words, interactions of other actions in the field also affect the structures and the processes of a specific buyer-seller dyad (Achrol, Reve and Stern, 1983). Following the line of argument that the environment plays an important role in affecting supply chain management, it is then the 'relevant' instead of 'latest' retail skills and knowledge that gives rise to competitive advantage in the context of international retailing, because the 'latest' retail expertise that a foreign retailer possess may not be applicable to a particular overseas environment. Infrastructure for information technology is not well developed in China, as mentioned before. Foreign retailers could not make use of the latest logistics and inventory management technology in China as if they were in other countries. They could not use their site selection science either, as discussed before. There are different business culture and norms within the distribution channel. The list of differences between the retail background in China and that of the countries that foreign retailers are used to is not exhaustive, and many of these differences are either demonstrated earlier or are discussed later. Therefore, competitive advantages do not come from the latest technology when a retailer operates in a different country; instead, it comes from the relevancy of the know-how to a specific background.

7.3 Retail Format and Formula

As mentioned before, retail format and formula is the element of retail know-how that is visible to consumers, which is manifested in different retailing mix and certain supporting cost structure. Retail format and formula also consist of retailing strategy that is actually the backbone of the retailing mix. Simultaneously, underlying a retail formula there is a certain cost structure. However, cost structures are not investigated because this is outside the scope of the present study.

In general sense, a product is always perceived as the individual items being displayed in a grocery store. However, on giving a closer look, a different meaning can be derived from the word 'product' in the context of food retailing[5]. The product produced by a car manufacturer is the car. The product produced by a clothing manufacturer is the clothes. In the same vein, the product produced by a grocery retailer should be the grocery store, which comprises basically everything in the store that are visible to the consumers. In other words, it is composed of more than just the individual items being sold inside the store. Other attributes that constitute the product—the store—include store size, assortment, store brand, decoration, store atmosphere, image, pricing policy and customer communication. These elements, when combined, form the retail format of a retailer, which partly gives rise to a retailer's competitive advantage.

[5] This concept is introduced very briefly in Chapter 6.

Investigation of the retailing mix of foreign retailers in China is beyond the purpose of the present research. Therefore, only those aspects that are most pertinent to the transfer of retail know-how are examined. One main element of format that is relevant and is investigated is retail concept. It is relevant because it is an important source of competitive advantage in the context of foreign direct investment. The other relevant element that is also examined is communication with consumers. It is relevant because the whole idea of retailing is to deliver what the consumers want. Therefore, communicating with consumers in order to know what they want is very important. This is especially crucial in the context of foreign direct investment because in a foreign country, particularly a developing one, foreign retailers face a very different set of consumers in economic, social and cultural terms.

Following the analysis of the above two elements of format is an investigation of adjustments made to the format and formula by foreign retailers for their businesses in China. This section ends with an evaluation of performance of foreign retailers in China and the impact of their retail format and formula on the local retail structure.

7.3.1 Different Retail Concepts and Formats

Tordjman and Dionisio (1991) found a strong correlation between internationalisation of a given form of retail activity and its success in the country of origin has been found. They maintain that particular European countries appear to have acquired a distinctive competence in a particular form of retail distribution and that the types of operation that are exported are mainly market leaders in their country of origin. For example, French hypermarkets (such as Carrefour), German discount stores (such as Aldi), and Dutch and German cash-and-carries (such as Metro) are dominant concepts in their country of origin that have reproduced abroad the key factors in their success. Different types of retailing possess different competitive advantages. That of hypermarkets lies in their low costs and high productivity; that of discount stores lies in their reduction in cost through reduction in assortment and service; that of cash-and-carry on cost reduction through bulk purchasing and reduction in service.

The concept of hypermarket was first introduced in Europe by the GB group in Belgium in 1962. It was born to fill the gap between the conditions prevailing in industrial manufacturing, which was mass production, and the conditions offered by traditional retailing techniques, which were inadequate and ill-suited to marketing such production. A hypermarket epitomises the techniques of discounting and self-service in the retail distribution of food and general merchandise items on a very large scale at low prices. The floor space of each store is normally in excess of 2 500 m^2. It usually operates with an average gross profit margin of 15%. The concept of hypermarket was spread to other European countries, notably France, soon after its birth. The lightning expansion of hypermarket in France following the opening of the first Carrefour store in 1963 constitutes the most remarkable phenomenon in the history of the distributive trades in France since the birth of the department store. French hypermarkets have begun to expand into other countries since the 1970s. With the exception of the United States where their success has not been demonstrated yet, hypermarkets have become popular primarily in countries where they enjoy a competitive edge over local businesses. By exploiting their know-how in a favourable environment, they have made considerable profits and achieved remarkable rates of expansion (Tordjman and Dionisio, 1991). Rapid expansion of the French hypermarket Carrefour in China has also been demonstrated.

On the other hand, the concept of discount stores was originated in post-war Germany. They usually have an average floor space of 500 m^2. These outlets are normally located on the edge of towns or off main streets. They carry a wide but low-stocked range of basic necessities, with a strong emphasis on their own brands, which account on average for 60% of turnover. Their average gross profit margin is about 13%. This aggressive pricing policy explains the success that they have had in Germany.

Cash and carry is a format that was made world-famous by German Metro. The founders of the company obtained the idea from the US. At the time just before the company was established, the founder saw that transportation cost was increasing significantly. Small to medium sized entrepreneurs could no longer keep pace with it. Consequently, the founders decided that it was the right time to introduce the concept of serving these entrepreneurs with a wide assortment, both food and non-food items, under one roof at low prices so that the entrepreneurs could get everything they want in one trip at good prices. German Metro has started exporting the concept as early as 1969[6].

The retailers interviewed in the present research operate supermarkets, hypermarkets, superstores, supercentres or cash and carry in China. Generally speaking, a supermarket is a full-line, self service grocery store of a size up to 30 000 square feet (2 840 square meter)[7]. A superstore has a sales area of 25 000 to 50 000 square feet (2 367 to 4 734 square meter). Any unit of over 50 000 square feet (4 734 square meter) is usually called a hypermarket. Superstores and supermarkets usually have their own substantial surface car parking spaces for their customers. They sell a range of 25 000 to 30 000 individual items, covering most foods and many non-foods (usually taking up 40% of the total selling area), at low prices (Cox and Brittain, 1996). A supercentre is a retail store of a combination of supermarket and discount stores with a size of above 200 000 square feet (18 935 square meter)[8]. Sometimes a supercentre is called a hypermarket. A warehouse store is a grocery store offering low price merchandise in bulk quantity in no-frill environments[9]. The readers should note that there is no universal definition for different retail formats. Different institutions define them slightly differently.

[6] This piece of information was obtained from the author's interview with a respondent who wished to keep his identity anonymous.

[7] Food Marketing Institute. 1998. *Language of the Food Industry: Glossary of Supermarket Terms* [Online] Available from URL: http://www.fmi.org/facts_figs/glossary_search.cfm. [Accessed 10th January 2002].

[8] Definition from *Defining Retail* [Online] Available from URL: http://www.discountmerchandiser.com/images/pdf/rr_guts.pdf. [Accessed 10th January 2002]

[9] Definition from *Defining Retail* [Online] Available from URL: http://www.discountmerchandiser.com/images/pdf/rr_guts.pdf. [Accessed 10th January 2002]

7.3.2 Empirical Results on Retail Concepts and Formats

Adaptation to local market demand is undoubtedly important to the success of FDI of a retailer. However, determining the extent of adjustments to one's retail elements is not an easy task. In order to preserve the vivid illustration of the adjustments different retailers made to their operations in China, the retail concept and format of foreign retailers in China are presented in detail in Table 7.1. The information was obtained through the author's fieldwork unless otherwise stated. Those statements in double quotation marks are direct quotes of the respondents of the corresponding retail company. In cases that more than one person was interviewed in a company, the corresponding respondent is given in brackets. Significance of these results is discussed in the next section.

Table 7.1 Empirical Results on Retail Concept and Format of Foreign Retailers in China

Company	Format in China Described by Respondents	Description of or Remarks related to Retail Concept & Format in China
A	Supermarket	***"In China, we are now modifying our concepts, hoping to find one that suits the local people most. So, now, our concept is just to serve our consumer best"; "Atmosphere is not a top issue."***
J	Supermarket	"Cater for everyday need."; "You have to have attractive offers. The consumers are different in different locations. You have to have a combination to make sure your customers will come back. So, you compete in the market with every element: promotional products, range, fresh food. What we are trying to do is that you can go into our store to get fresh food, bakery, hot food, chilled, frozen, grocery, other general merchandise, etc. You have to cover the major products that people need daily."
C	Supermarket	
M	Supermarket	
L	Supermarket	"We target middle class people living nearby."
B	Supercentre	
E	Superstore	"We call our store superstore, meaning that we are not a traditional supermarket selling food. People in Guangzhou and Shenzhen in general do not like shopping in department stores because department store is of a different social class. Nevertheless, they like superstore because in terms of assortment, superstore is similar to department store, but superstore does not have too much decoration and products are offered in a lower price. People here just love this concept because they can buy a lot of different things in one

		stop and can shop comfortably in this kind of setting."
G	Cash & Carry	***"Traditional Cash and Carry concept but we have shorter racks than Metro and more and better display. We also have fitting rooms for our customers to try clothes on before they buy it. Of course, we use magnetic security system to guard against theft."***
H	Supercentre	"Typical supercentre similar to Wal-mart supercentre stores"
I	Hypermarket	"We bring the traditional French hypermarket concept."
D	Cash & Carry	Aims at niche; have customers profile on our record; good track on their spending pattern; need a good match between customer types and merchandise mix; "we've got our own formula for our business worldwide."
F	Cash & Carry	"We chose this concept because there is hardly any competition of this type of stores in China, not like hypermarkets.......Cash and Carry concept means low cost structure, low prices so that our customers can sell the products with their budgets. We are mass merchandising, with high racks: 7 m high. No frills. No decoration. Offer full range of food and non-food products. The proportion of food to non-food products varies from country to country. We need high rotation, low stock set: the duration of stock must be less than payment credit so that suppliers finance our stocks." (Chief Operating Officer); "We looked at population, population density, density of retailers, and the like in deciding to go ahead with Cash and Carry concept......Cash and Carry concept works on a given combination of average invoice, SKU prices and traffic. We need high value of invoices but low traffic, about 1/4 to 1/5 of traffic of hypermarket, about 1.7 times the turnover of hypermarket and we have about 1.7 times or more of their floor space." (Chief Food Purchasing Officer); "Hypermarket needs 1 million of customers per year to survive, but Cash and Carry needs only 10% of that. We need to stick to our concept everywhere we go." (General Manager); "Our main concept is to have low cost: having stores and offices away from city centres, simple offices and stores with the minimum decorations, buy in bulk, no or minimum processing of merchandise on our side, good complicated computer system to manage inventory. In other words, we need to minimise our operation costs in long term." (Chief Non-food Purchasing Officer)
K	Cash & Carry	Require customers to register so that they can form a database of their customer's profile.

(Con't)

Company	Competitive Advantages
A	
J	A good retailing mix
C	1st: Human Resource; 2nd: Peace; 3rd: Location
M	"We have got only one store. It is difficult to compete on price. So, we compete on assortment and freshness of fresh food. We also use our expertise from home country to deal with store atmosphere and decoration."
L	Quality, Assortment and Shopping Environment. Company L's slogan: "Take your time, enjoy your shopping".
B	
E	"In China now, the most important thing element that consumers look at is price, secondly, it's service and third, shopping environment. By service, I mean the enthusiasm of our staff towards our customers. Our staff has been doing really well in this regard. One of our retail concepts is to be a 'Home town store', meaning that the people nearby will come round and feel homely. We found that this is very important for our business here."
G	Convenience, cheap, good quality and good service
H	
I	"If you can find the same thing cheaper somewhere else, we will give you the difference." "know-how in selling fresh food"
D	
F	Efficiency (Chief Food Purchasing Officer)
K	Competitive advantage comes out of productivity and efficiency, which depends on the unit size of products to be sold and how they sell it; "Having low prices is also important, but it is also important to have a good combination of different factors. First of all, your buying activities. You have to get good prices from suppliers. This is mainly related to the payment and volume when you buy. So we have to keep on developing new stores and growing in order to have that advantage and manage the value of our organisation on top of our buying prices."

(Con't)

Company	Store Size	No. of Product Lines (SKU)
A		3 000-4 000
J	One is 2 000 sq. m. The other is 1 200 sq. m (selling space)	8 000 (in which 1 200 are imported)
C	Whole GMS: 11 400 sq. m store size; 7800 sq m sales areas; Supermarket sale area: 2700-2800 sq. m.	
M	Supermarket: 1 500 sq. m store size; 1 000 sq. m sales area	20-25% is fresh food items
L	Whole supermarket: 5 000 sq. m	

B		***16 000 currently, will be increase in the future***
E	30 000 sq. ft (2 840 sq. m) selling area	14 000 SKU; product range must be broad. Smaller suppliers each on average supplies 20 to 200 SKU
G	12 000 sq. m store size	15 000
H	1st store: > 20 000 sq. m store size. Others: 8 000 sq. m	more than 10 000
I		***If different colour and size are counted as the same product, 12 000 products. Don't know whether will increase this no. or decrease. Need to wait and see. The norm for large scale supermarket in Beijing is about 10 000-20 000 products***
D	***selling space: one store is 12 000 sq. m. The other is 11 000 sq. m. non-selling space in store is about 3 000-4 000 sq. m.*** ***Looking for a new store with gross space in store of 12 000-12 500 sq m. The size of first two stores here are of European standard. Smaller size will be adequate for China. So, we need a site of total area of 30 000 sq. m, so that we can have roads and about 400-500 parking slots. A floor space of as low as 10 000 sq. m will also be suitable here, depending on the city.***	about 12 500 to 13 000
F	Largest: up to 20 000sq.m (worldwide); 15 000sq.m (China); Sale Area: about 8 300 sq. m in China; Traditionally: 2 floors, one for food and some non-food and the other for non food	***No intention to increase the no. of products because for a cash and carry, it is important to have a full range of different items but not into depth. "We need high rotation and to gain productivity, we need to sell high volume to big customers such as factories" (Chief Operating Officer)*** ***Food: 5 000 (same as original concept), non-food: 7 000-8 000 (SKU) (multi pack and single pack of the same product are counted as 2 SKU and so the actual number of articles is lower), intend to decrease no. of products in the future (Chief Food Purchasing Officer)***

K	Selling space: 10 000 sq. m	***14 000. Probably will increase this no. in the future, especially on non-food items***

(Con't)

Company	Product Focus	Food/Non Food Proportion
A	***"Fresh food is becoming more important, but our main emphasis is still packaged food."***	
J		"Not much selling space is devoted to fresh food, as we would normally do, because we are in commercial location here, where we don't need that much fresh food."
C	***Fresh Food***	400 sq. m for fresh food, which is about 18% of floor space of supermarket; they account for about 23% of sales of supermarket
M		***about 30% of sales space for fresh food; similar ratio for sales. "we want to increase the proportion of fresh food in the store and we also want to increase the supermarket store size to increase overall sales."***
L	***Meat, fish, delicatessen***	1 000 sq. m for food. Fresh food accounts for about 30% of sales of supermarket.
B	***Fresh food and electronic goods***	
E	***Fresh food, cooked food, bakery, and personal care products***	Fresh food accounts for about 20% floor space. Sales: Vegetable+fish+meat=15%; bakery+cooked food+dairy products=15%
G	***we don't have one particular focused item***	Fresh food: 7-8% sales. Fresh and frozen food account for about 25% of selling space by observation.
H	***daily products and food***	15%-20% floor space for fresh food
I	***Fresh food, "this is our competitive advantage"***	***Proportion of Fresh Food in China is greater than in home country, both in terms of sales and floor space.***
D	***Fresh food. This is what generates traffic in stores. "We will upgrade the fresh food area when this current store is 3 years old."***	In China, chilled products+vegetables+meat: about 3 000 sq. m, which is about 20%-25% floor space. Fresh food accounts for about 30% of sales
F	***Fresh products: perishable, meat, vegetables, fresh fish and dairy products.***	Fresh and Frozen Food: about 25%-30% (both sales and floor space)

K	***"basically you have to use different products, pricing and display to get people in the store to generate traffic. It is difficult to say which product is our focus."***	Fresh, frozen, chilled and pre-packed food: about 25% of selling space and sales

(Con't)

Company	Average Basket Value (RMB 8.3 = US$ 1)	Shrinkage
A		Between 1% and 2% "manageable. We put in extra effort, such as CCTV. The percentage is not bad compared to that in home country"
J	20-30 rmb	"It is a problem everywhere. Our rate is fairly well controlled. We are trying to budget it below 1% and we are pretty close to it......we use security guards, electronic systems and CCTV."
C	about 30 rmb "this is not a very high value but higher than most state owned retailers, where they get about 20 rmb"	"We moved staff changing room to outside the store so that they passed through security before they leave go to changing rooms. This reduced our shrinkage by 50%......The rate has been decreasing each year in the past and now it is about 1%."
M	10 rmb (about 5 items)	Very serious
L		stealing is very serious, more serious than in home country. For example: some customers drink and eat in the store before checkout. Once, the GM of the distribution centre of this company saw a mother give her child an ice-cream from the store to eat in the store; serious staff stealing too. Use CCTV and security guards
B	Not disclosable	"we have very good approach and procedures on control this aspect. So, this is not a problem to us. Our main shrinkage is due to procedural mistakes, negligence but not really theft."
E	20-30 rmb	About 0.5%. "for state-owned enterprises, normally it is 1%, some even get a shrinkage of as high as 10%......Main reason for shrinkage is staff and customer stealing.....we use CCTV and security system to guard against stealing."

G	130 rmb on average (host country: equivalent to 200-250 rmb)	catch about 600 incidents of theft in half a year, but still control the shrinkage between 0.2-0.3%. Customers sometimes damage goods in store. Example: once the Operating Division Specialist saw a customer pick up a frozen product and then put it on a normal shelf. She once also saw a customer eat the bakery they sell inside the store without buying.
H	80-90 rmb	Very serious, use CCTV
I	100 rmb approximately	not disclosable
D		about 0.3%. ".....within our tolerance, and surprising this is smaller than in the UK. This is very low and our rate is better than a lot of other business counterparts."
F	not disclosable, but about 8-9 times higher than Carrefour (GM); From very little up to a few hundred even thousands rmb sometimes (Chief Food Purchasing Officer)	Far under 1%, which has always been the case, because of our high volume and turnover. (Chief Food Purchasing Officer); about 0.61%, "in line with industry rate" "for our industry, it is acceptable when it is within 2%"; "It's just the advantage of cash and carry. You have less people and so you have less shrinkage due to damages made by people. On weekends, you have 20 to 40 thousand people in this store. You have automatically a lot of theft and damage. There is no way to avoid it. But normally, we have less people but high turnover per person and less shrinkage." (Chief Non-Food Purchasing Officer)
K	170 rmb	Very high, three times higher than in Europe. Mainly due to staff stealing because staff here have different mentality. What this company does is to lay staff off if caught for stealing.

(Con't)

Company	Average Gross Margin	Frequency of Store Visit by Customers
A		
J		at least 1/wk, or 2/wk or 3/wk. They are people who live or work nearby
C	Between 10% and 20%	more than 3-4/wk. Neighbourhood consists of people with higher income, e.g. university staff. More customers over weekends.
M	about 16.5-17%	70% customers visit daily or 1-2/wk. Catchment is about 200 000 population

L	about 20%, which is lower than in home country, probably because "we have lower buying power here than in home country."	expect customers from within 5 km of store, buy daily. Most of customers come on foot.
B	Not disclosable, but lower than in home country	Exact frequency not disclosable. In home country, 1/wk. In China, more often.
E	about 20%, which is "quite an acceptable rate, but we want it to be higher"	1-2/wk. Customers come on foot, by bicycle, or motorbike (no on site car park but cars can be parked in surrounding area)
G	8-9% on average. "our boss do not want to set too high a margin"	1-2/wk.
H	Between 10 % and 20%, which is "similar to Metro and Carrefour"	1-2/wk. Customers mainly from neighbourhood. There are most customers on Sundays.
I	10%-15% here vs. 15-18% in home country	2/wk. Customers come by car, taxi, bus, bicycle, or on foot.
D	about 10.5%. For food, the margin here is lower than that, and for non-food, the margin is higher than that.	once every 2.5 wks on average. 85% customers live within 30 mins of store. Customers come by car, motorcycle, tricycle, bicycle, taxi, bus, all means.
F	10-11%, which is lower than in their home country. This is about half of that in their home country. (COO, Chief Food and Non Food Purchasing Officers) Because of this, need 6 stores to be profitable.	Depends on customer group. Some visit the store as often as 2-3 times a day (Chief Operating Officer). Some 1/wk (General Manager). Depends on time zone. Some customers live as far away as in Heilongjiang, Jiangzi, Qinghai. For these customers, they may visit the store about once a month or once every two months, but they normally buy more each time (Chief Food Purchasing Officer).
K	about 10%	5 times a month. Customers come to store by all sorts of different means.

(Con't)

Company	Adjustments Made that were Specifically Pointed Out by Interviewees
A	Brands, assortments; **"taste, lifestyle and habits are very different here...need to understand local preference...the store format here at the moment is very similar to that in our home country. However, I believe that it should be different. But this is a process of adjustment, depending on what local people like. We first put our home country model into China to test and change continuously towards a model that suits local people's preference. It is difficult to tell how different the model here will be or should be, because it is a continuous process of adjustment. Even the stores in our home country, we are also changing them continuously to suit the needs of people there. Format keeps evolving. Moreover, when at one time there are more than one store, more than one format will evolve. In China, we are at the very early stage of format evolution."**
J	"There is adjustment as far as range and everything but you won't see a big different to our original concept. Also, you have to look at the location to see what type of customers is around. In some stores, you can't sell products that are too expensive or too high end. In our home country, different stores in different locations are a bit different in terms of assortment. However, our focus is still the same, which is freshness and convenience."
C	Mainly food, need to adapt to local taste and seasonal change. At the beginning, they sold fish in aquarium, but they found it costly to keep them alive and it needed a very special skill to do so. Fish died a lot and so after about 4 weeks, they stopped selling fish in aquarium.
M	*The adaptation process of this company is discussed in detail in the next section.
L	mainly different assortment
B	mainly assortment and packaging
E	"A lot of elements in our system/concept are not applicable to the China market. For example, our stores outside China are very well decorated, which are comparable to Wal-Mart. However, cost of decoration is too high in China. Also, there is no such thing as image design in China. Therefore, there are a lot of things we used to do but can't be done here. As a result, we are concentrating on product assortment, quality and services at the moment......Another example is that we have a standardised store evaluation system. But now in China, the system is not completely applicable. We need to and are modifying the evaluation form to suit China. **A lot of elements in our formula need to be modified to suit China. It takes time. It is a process. Of course, the core ideology is the same, but then other things about how to achieve that ideology, i.e. the executive things, have to be adjusted according to the environment."**
G	
H	
I	"A lot of issues concerning fresh food are different here. We can't simply copy what we do in home country in this aspect because we need to suit the Chinese market. We choose fresh food products that are best sold in China. However, say for beef, we use our home country's cutting method here, because the 'beef culture' in our home country is much better developed than that here. Also because of that, we have a lot of information about how to cook different parts of beef and what kind of beef goes with what kind of cuisine. Nevertheless, the 'pork culture' is better here. So, we adopted the Chinese 'pork culture'." They pack their own fresh food, make their own

	Chinese 'pork culture'." They pack their own fresh food, make their own bakery and some ready meals themselves in store.
D	**Don't want to go away too much from their formula, because the most important thing is to maintain the economics of their business. If not, they will lose.** But adjustments have to be made whenever suitable. One example: "I was sitting in my office doing my China study and five people came on tricycles. They had the same merchandise on their tricycles. So, I was looking at the economics of having five tricycles delivering at our company. It didn't make sense to me. It didn't fit my idea of supply chain management. So, I pointed it out. These local people thought what they were doing was very normal and didn't even see there was anything wrong. So, I asked them what it was, the merchandise, and what else had been happening. The answer literally came back, it was a cookerhood, so it is quite like merchandising but it was bulky. So, the five tricycles with the men paddling, came in convoys, we had a convoy for those people. They put to me that it was more economical to deliver that shipment with five people. That was a saving on the supplier side. But they also showed that if they needed a sixth tricycle, it would be cheaper to send it on a truck. Moreover, there are restrictions in transportation in Beijing. With tricycles, these guys can move and delivery more freely than a truck. So, in China, there are these little bits to which Western logic would not be applicable. We try to change and modify the Chinese system but we also need to work with the local system."
F	Mainly assortment; bigger packaging here than in home country and broader assortment here because customers want variety instead of volume here. for example, they prefer buying 30 bottles of different whisky to buying 30 bottles of one whisky (Chief Operating Officer). Sell fish alive in China (General Manager). Sell multi-packs here, but not in any other countries because of different customer's needs (Chief Food Purchasing Officer).
K	Basically follow the same rules worldwide; Sell more food in Europe, because of a heavier focus on catering clients there.

The information presented in Table 7.1 demonstrates that making adjustments to different elements in their retail operations to adapt to market conditions is crucial to retailers. The elements that were changed range from product focus, number of product lines, store size, assortments, brands, packaging to even the core concept of retailers. The empirical results in bold and italic, and in the column named 'Adjustments made that were specifically pointed out by interviewees' are the more prominent examples of adaptation effort of the retailers interviewed. A detailed discussion of the adaptation issues that are reflected by the empirical results is given in the next few sections.

7.3.3 Adjustments to Retail Format and Formula

The empirical results in the previous section reflect some adjustment-related issues that are worth examining in detail. First, different retailers viewed their competitive advantage differently. Some retailers believed that competitive advantages come from a concept. An example of such concept is "take your time, enjoy your shopping" by Company L. Another example can be taken from Company E, who believed that they could win customers by packaging and presenting their stores as "home town stores". Some other retailers perceived competitive advantages as something to do with numbers. Company K stated that their success was derived from the concept of selling high volume at low prices with a low cost structure and hence they would stick with this concept regardless of where they go. Some retailers, on the other hand, considered their competitive advantages to be derived from a practical skill, such as Company I, who claimed that their competitive advantage was the possession of superior skills in controlling and maintaining freshness of food. Regardless of how retailers perceived their competitive advantages, an appropriate combination of different retail elements is significant in realising their competitive advantages. When adaptation is made, retailers tend to retain their core concept and change the combination of their other retail elements.

The retailers interviewed, as shown in the empirical results, made adjustments to a number of retail elements of their operations in China. When they engaged in foreign direct investment activities in China, they kept their core concept and changed their retail mix in order to achieve a combination that would suit the condition and need of a particular market while maintaining their core competence. The retail elements that are to be changed were termed 'the executive things' by the Executive Director, Finance, of Company E, as shown in the last column of the table. The elements that the retailers interviewed changed included number of product lines, store size, product focus, product assortment, range, packaging and product brands. In China, freshness of food is very important in Chinese eating culture and therefore they had to adjust their product focus to give emphasis on fresh food. All of the retailers interviewed offered a large proportion of fresh food in their stores in China. Store size was also seen as one element that had to be adjusted when retailers went to China. As shown, Company D claimed that a smaller store size than that they usually had elsewhere in the world would suit the Chinese market better. On the other hand, from the last column in the table, assortment and packaging appear to be the most obvious elements that need to be changed when a retailer transfers their expertise to a new market. One must note that adaptation to a new environment does not only happen when a retailer first enters a new market. This is a learning process that takes time and requires hand-on experience in the market. The retailers interviewed continuously made changes as they learnt more about the market through their operations day by day.

Apart from making adjustments to different retail elements, continuously fine-tuning of their retail concepts in each country in which they operate is also crucial. This is the learning and adaptation process that gives rise to the evolution of new retail ideas. The case of Company M serves as a good illustration on this point.

> *Company M wanted to establish a modernised supermarket that offered high quality of fresh food in China. However, they encountered objection from their Chinese partners to investment in selling fresh meat and vegetables. There were two main reasons for the objection of their partners. The first reason was that the fresh food offered in their store would be more expensive than those in wet markets because they had processing and they had to add 17%VAT on their prices, in which case consumers might not be willing to buy in their stores. The second reason was that controlling freshness of food required a specific skill.
>
> For the tax-related problem, Company M later found out from the municipal government that the VAT on fresh food was only 5% instead of 17%. Moreover, they tried to purchase in larger quantity to reduce cost. Consequently, the problem with high prices was solved.
>
> For the problem of freshness control, Company M admitted that educating the staff to control the quality of fresh food from purchasing, processing to selling was very difficult. In addition, obtaining meat with freshness guarantee in China is also difficult. Consequently, they decided to operate the meat department in their store jointly with a reliable, large scale meat producer who had been supplying meat to Company M because this meat producer had the know-how to control the freshness of meat. That way, the meat purchasing, processing and in-store freshness control and selling were managed by the specialists who were sent by the meat producer to Company

> M. Instead of charging the meat producer for rent, Company M charged them a fix percentage of their sales every month and the rest of the sales belonged to the meat producer. Company M found that this was a very good solution and the meat sales had risen dramatically.

The tenet of continuous fine-tuning of retail concept is also well illustrated by the remark of the Director of Company A as shown in the table under the column 'description of or remarks related to retail concept and format in China' and the last column. "Formats keep evolving." Company A started off their retail operation in China with their concept at their home country. Then, they learnt from their daily operation and modified their concepts continuously, hoping for the evolution of a concept and format that would best suit the Chinese market. The Director of Company A further pointed out that this fine-tuning process also existed in their operations in other countries and their home country. This example reflects exactly what the author advocates in the analytical framework of international transfer of retail expertise at the beginning of this chapter. The transfer of retail expertise is in essence a process of learning and adjustment that leads to the evolution of innovative retail ideas and concepts that are crucial to the success of retailing, given the dynamic and diverse nature of consumer markets.

Other Operational Issues Unveiled by the Study

In addition to the adjustments that foreign retailers made on their operations in China discussed above, the empirical results presented earlier also reveal several retail operational issues in China that are worth noting.

First, all of the retailers interviewed maintained a gross margin of between 10% and 20%. Four retailers claimed that their gross margin in China was lower than that in their home countries. The General Manager of the distribution centre of Company L claimed that this was probably because they had a lower buying power in China than in their home country.

Second, the average basket value for foreign supermarket retailers interviewed ranges from RMB 20 to RMB 30 (US$ 2.4 to US$ 3.6), except for Company M and Company L. Company M had only about RMB 10 (US$ 1.2). However, the average frequency of store visits by their customers was higher for Company M than for other supermarket retailers interviewed. One main difference between Company M and other supermarket retailers interviewed is that Company M located in sub-urban area. Therefore, one plausible implication is that sub-urban consumers had different consumption patterns to urban dwellers.

Third, the frequency of store visit for most retailers interviewed, except Company D and Company F, ranges from one to four times a week, regardless of whether the company is a supermarket retailer, a supercentre retailer, a superstore retailer, a hypermarket retailer or a cash and carry. This reflects that consumers in China tend to shop more often than consumers in Europe or the US. "The people here are used to buying everyday to suit their daily needs," said the Agriculture Specialist of the US Agricultural Trade Office in Guangzhou. Moreover, physical household size in China in general is smaller than that in Europe and the US. Consequently, there is less storage space in a normal Chinese household. This contributes to explaining why Chinese consumers tend to buy a small amount of goods every time but shop more frequently. The frequency of store visits of the patrons of Company D and Company F differ from that of other retailers interviewed. This is probably due to the fact that the patrons of Company D and Company F tended to be the non-end users, such as restaurants and other smaller retailers, which were the target customers of the two companies.

Lastly, four retailers claimed that theft was a very serious issue in China. Most of the retailers interviewed believed that theft is the main cause of shrinkage in China. Rigorous control measures had to be taken. CCTV and security guards were used in stores. Furthermore, the author observed that most of the foreign retailers in China required customers to put all their belongings in lockers located just outside the entrance of the stores before they enter the stores. Theft was not only caused by customers but also staff. Most of the retailers interviewed appeared to be able to control their shrinkage rate below 1%, which most of them claimed as not too bad and tolerable.

7.3.4 Communication with Consumers

The axiomatic aim of retailing activities is to satisfy consumer wants and needs. Therefore, communication to customers about their needs and satisfaction on their visits is important. Furthermore, the strategy that a food retailer adopts on customer communication partly constitutes to the distinctiveness of the product (the store) the retailer offers. The degree of devotion of a retailer to customer communication reflects its commitment towards satisfying its customers.

Customer communication involves the way in which customers are treated by the staff of the store (this is called the interpersonal element), the channel through which customers can make complaints and comments, the policies on dealing with complaints, the refund policy and the delivery of store publications to customers. These elements offer scope for differentiation and customer satisfaction to food retailers (Bell, Gilbert and Lockwood, 1997), because, for instance, given the comparatively low level of direct staff involvement in the grocery store shopping experience, the involvement of interpersonal element has a significant and frequent impact on customer perception on the store. Food retailers who can guarantee good interpersonal interaction will gain advantage (Bell, Gilbert and Lockwood, 1997). This is a belief shared by Company E, who stressed that one of their main concepts was to be a "home town store", as mentioned in an earlier section. Furthermore, customer services and communication provides a more effective way to increase market share than price competition (Bell, Gilbert and Lockwood, 1997).

This section investigates very briefly the type of consumer research that foreign retailers in China conducted, the difficulties, if any, they encountered in doing so, some statistics on food consumption pattern and Chinese consumer behaviour that is related to the foreign direct investment activities of foreign retailers in China. The reader should note that a detail study on the topic of market and consumer research, consumer behaviour and consumption pattern, and promotion in China is outside the scope of this thesis.

7.3.4.1 Consumer/Market Research

No information about consumer research was obtained from Company C. All the other twelve retailers interviewed carried out some sort of consumer research themselves. In some companies, the research was carried out by the store manager, and in some other companies it was by a special team such as marketing team. Seven retailers conducted the research continuously but most of them were not on a regular basis. The Executive Director of Company E pointed out that they planned to conduct the research regularly in the future. The methods they used included informal chat, proper survey and focus group with customers inside their stores. For the other five retailers, two of them had conducted similar consumer research only once at the time of interview but both of them stated that they were planned to do another one soon after the time of the interview.

The other three retailers, Company F, Company D and Company K, operated Cash and Carry in China and they had a European origin. Membership was required in order to shop in these three companies. Their target customers were the more professional clients, instead of end-users. During membership registration, customers had to provide much information. Consequently, a database was formed, which was updated continuously as their customers made purchases at the store. Furthermore, all these three retailers claimed that they regularly invited their customers to have meetings with them or paid visits to their customers to discuss their needs and buying profiles. The General Manager of Company K alleged that they also regularly conducted presentations to about 20 customers each time to educate them about Company K's concept and how Company K could benefit their businesses. On the other hand, according to the Chief Operating Officer of Company F, they had 15 representatives who were devoted to maintaining contacts with customers. Apart from constantly posting direct mails about promotional activities and news of their stores to all their registered customers, they kept track of customer profiles continuously and visited the bigger customers regularly and contacted the smaller customers by telephone. All these three companies stated that their customer database and communication with customers were enough to serve the purpose of knowing about their customers and letting their customers know about them.

One retailer, Company K, claimed that people in China were less willing to spare time to participate in consumer research activities than the people in Europe. On the contrary, four of the twelve retailers interviewed, Companies J, F, E and L, pointed out that Chinese customers were very willing to spend time on participating in their consumer research activities. The Chief Non-Food Purchasing Officer stated that once their company had demonstrated that they took customer's opinion seriously, their customers were quite active in providing comments. The other seven retailers interviewed did not give any information on the attitude of Chinese consumers towards consumer research. Although the author's results on the attitude of Chinese consumers towards consumer research is far from conclusive, it poses a challenge to Yau's (1988 in McDonald, 1991) claim that effective customer communication in China is difficult to achieve because Chinese people do not demonstrate overt complaint activity.

In terms of market information, most retailers interviewed claimed that there was not much market information available in China. The way they obtained information about competitors was mainly by store visits to their competitors to check their price and products. The Executive Director, Finance, of Company E stated that they mainly obtain market information through informal means.

> "We have a lot of colleagues who worked for other retailers before joining us. They have very good network and channel to find out what's going on in the market and with other retailers......Also, we are a member of the Chain Store Association here and we obtain quite a bit of market information there informally."

According to an Agricultural Specialist of US Agricultural Trade Office Guangzhou office,

> "The availability of market information is pretty pitiful in China. It takes a lot of effort to get some useful information. It is true that there are market research companies here who are willing to provide market research services for you. But the problem is that the price they charge is ridiculously high. Moreover, they are mainly local companies. They are poor at best. They don't quite understand what you really want. So, if you want real market information, it is very difficult to get."

Company A claimed that they had use consulting companies to carried large scale, more sophisticated consumer/market research. Company K also stated that they did one market research jointly with AC Neilson in China.

7.3.4.2 Consumption Pattern

As mentioned before, China, occupying an area of 9 596 960 square km, cannot be treated as one homogenous market because each place has its unique social, cultural, economic and political background. Consequently, characterising the 'typical' Chinese consumers is meaningless. For retailing purpose, each city has to be looked at individually. The current section details some statistical figures related to urban consumption patterns in Beijing, Shanghai and Guangdong. The statistical figures are obtained from China National Bureau of Statistics (1999b) unless otherwise stated.

In urban areas, the average number of people per household in 1998 is 3.16, in which 2.18 people are income generators. In the same year, the average annual expenditure of a person in urban households is RMB 4331 (US$ 521.8), which accounts for 79.8% of the RMB 5425 (US$ 653.6) average disposable income of a person in urban households. 44.5% of the average annual expenditure is on food (Table 7.2). In other words, a person in urban households, on average, spends 35.5% of his annual disposable income on food.

The average urban diet contains a high proportion of meat, grain (mainly rice) and vegetables. In urban food sales, there is a greater expenditure in the fresh produce sectors. Although the majority of households in urban area in China own refrigerators (Table 7.3), meat, fish, poultry and vegetables are mostly bought on a daily basis because Chinese people prefer having fresh produce every day when they cook at home (Anderson, 1988 in Goldman, 1998). A detailed breakdown on the food expenditure of an average person in urban households in Beijing, Shanghai and Guangdong is given in Table 7.2. In Shanghai, consumers spend about 60% of their food retail purchases on fresh food (China Statistical Publishing House, 1995 and Euromonitor, 1996B in Goldman, 1988). Basing on their emphasis on fresh food in their stores, as shown in the 'empirical results' section, the foreign food retailers interviewed appear to have responded well to this Chinese consumer's need of freshness.

Alongside the increase in average urban incomes, which allows for more frequent consumption, the consumption on meat has increased fastest in value terms. Moreover, a greater spending on more expensive and better quality meat because of increasing awareness of quality among Chinese consumers has been shown (Euromonitor, 1996). At the same time, fruit and vegetables are also important to Chinese diet. According to Mueller and Mueller (1996), the perception of food quality can be improved with store layout and cleaning of the produce before displaying. Consequently, an increasing number of consumers buy food in modern food retail stores in which there is pleasant shopping environment and better display. The Vice General Manager of Company M described,

> "Consumers here increasingly care about hygiene, especially in the summer. A lot of them still go to wet markets to shop, but their frequency of buying meat from those markets is decreasing. This is because their living standard and knowledge of hygiene are rising."

On the other hand, car ownership in China is very low, as shown in Table 7.3. So is motorbike ownership, except in Guangdong, where, on average, almost one in two households owns a motorbike. However, bicycle ownership is very common in China. Therefore, most consumers make their shopping trips on foot, by bike or motorbike.

7.3.4.3 Consumer Behaviour

In Europe or America, different formats target different customers and consumers are able to distinguish among different formats. However, in China, this is not the case. There is no doubt that the warehouse clubs in China claimed that their target customers are professional customers, but a closer investigation revealed that they are in fact giving in and retailing instead of wholesaling. Evidence suggests that people without a membership card were able to get into the outlets, or membership cards were easy to obtain without the need to produce a business certificate, and items were sold individually or in a small pack instead of in bulk. The author attempted to make purchase in a number of different warehouse clubs and cash and carry in China without a membership card. When asked, the staff responded that the author could just borrow a membership card from someone in the queue at the checkouts. It appeared that the membership policy was not well implemented. These phenomena were discussed with the respondents during interviews. They explained that the consumers in China were not capable of distinguishing among different retail formats and educating and soliciting business from professional consumers takes time.

> "They just don't understand! Everybody wants to shop in our stores and they just don't care what your format is. If you don't let them shop here, they will get annoyed with you", pointed out by the Chief Operating Officer of Company F.

The point that Chinese consumers cannot differentiate among different retail formats is further supported by the author's interviews with some government officials who were involved with economic development and FDI in China. Regardless of the format of a retailer, whether it is a hypermarket, supercentre, cash and carry, warehouse club, or the like, Chinese consumers called all of them '*damaichang*' meaning a big marketplace selling a very wide range of products in reasonably low prices in a clean and modern self-service environment. This is all the knowledge that they have of foreign food retailers in China, and is also the image that foreign food retailers have created. Shopping in these outlets has become a convenient and fashionable way of shopping. The author observed during her fieldwork that some consumers even took taxi to go to and leave from these '*damaichang*'. This behaviour shows the popularity of these outlets among Chinese consumers, considering the average income of the people. In fact, the format of '*damaichang*' has been extensively copied by many local retailers in China soon after the entries of foreign food retailers. According to the General Manager of Company K, some local '*damaichang*' retailers even partly copied the Chinese names of those foreign '*damaichang*' such as Makro and Metro, which are '*Wankalong*' and '*Maidelong*' respectively. Two examples are *Jinkalong* and *Tiankelong*, who are two local food retailers in Beijing. The widespread imitation of the '*damaichang*' concept further indicates the popularity of those large-scale foreign food retailers among Chinese consumers.

According to the behaviour model of purchase and consumption (Foxall, 1993)[10], consumer behaviour is affected by both current behaviour setting and consumer's learning history. The behaviour setting is made of all the physical, social and temporal elements that indicate the likely consequences of behaving in a particular way. Consumer's learning history is the cumulative effect of rewarding and punishing outcomes of past behaviour. As mentioned before, the consumers in China possessed little information and purchasing experience about modern retailing prior to 1992. When the market was open to foreign retailers, many different formats of retailing were brought into China within a very short period of time. Consequently, Chinese consumers suffered from an 'experience gap' between the old Chinese concept of food shopping and the modern way. Mun (1988) claims that when consumers do not have a solid history about consumption, they are susceptible to ideas and influences. This 'catch-up' mentality offers a plausible explanation to the swift take-off of the format of '*Damaichang*' in China soon after its first appearance. In fact, many marketers of foreign brands have been surprised by the speed with which their brands gained acceptance among Chinese consumers (Mun, 1988).

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[10] For further details of Foxall's behaviour model of purchase and consumption, please refer to his article.

Table 7.2 Average Expenditure on Food by a Person in an Average Urban Household 1998

	Whole China (Rmb)	Whole China (%)	Beijing (Rmb)	Beijing (%)	Shanghai (Rmb)	Shanghai (%)	Guangdong (Rmb)	Guangdong (%)
Total expenditure	4331.61	100	6970.83	100	6866.41	100	7054.09	100
Total food expenditure	1926.89	44.48	2865.73	41.11	3467.95	50.51	3112.52	44.12
(1) Rice and noodles	226.79	5.24	256.95	3.69	260.77	3.8	263.24	3.73
(2) Potatoes types	20.36	0.47	23.62	0.34	23.7	0.35	12.82	0.18
(3) Bean and bean products	34.03	0.79	41.13	0.59	64.47	0.94	28.5	0.4
(4) High fat content products	75.26	1.74	72.49	1.04	97.75	1.42	91.1	1.29
(5) Meat and meat products	431.23	9.96	590.64	8.47	690.54	10.06	895.44	12.69
(a) Pork			228.49	3.28	289.47	4.22	363.82	5.16
(b) Beef			54.61	0.78	22.89	0.33	33.55	0.48
(c) Mutton			55.84	0.8	7.11	0.1	6.99	0.1
(6) Egg	67.06	1.55	78.47	1.13	76.99	1.12	51.2	0.73
(7) Seafood	142.46	3.29	128.24	1.84	532.18	7.75	346.8	4.92
(8) Vegetables	197.02	4.55	233.48	3.35	311.61	4.54	292.7	4.15
(a) Fresh Vegetables			214.26	3.07	280.41	4.08	256.38	3.63
(b) Dried vegetables			8.33	0.12	17.28	0.25	22.8	0.32
(c) Processed vegetables			10.89	0.16	13.92	0.2	13.53	0.19
(9) Seasoning	28.02	0.65	56.95	0.82	44.45	0.65	29.54	0.42
(10) Sweets	24.06	0.56	42.81	0.61	42.91	0.62	34.42	0.49
(11) Tobacco	93.56	2.16	90.96	1.3	145.41	2.12	73.02	1.04

(12) alcoholic and non-alcoholic beverage	91.57	2.11	180.13	2.58	139.26	2.03	71.45	1.01
(13) Fruit	120.73	2.79	204.38	2.93	212.18	3.09	174.84	2.48
(14) Nuts	24.27	0.56	52.51	0.75	42.59	0.62	21.55	0.31
(15) Bakery	40.39	0.93	100.45	1.44	102.57	1.49	59.06	0.84
(16) Milk and Dairy Products	48.05	1.11	113.27	1.62	142.73	2.08	48.9	0.69
(17)Others	34.28	0.79	100.66	1.44	113.89	1.66	82.47	1.17
(18) Eat out	227.01	5.24	498.12	7.15	423.88	6.17	535.1	7.59
(19)service charge for food processing	0.74	0.02	0.48	0.01	0.05	0	0.38	0.01

Source: China National Bureau of Statistics. 1999b. *Annual Statistics on Retail Prices and Urban Household Income and Expenditure in China 1999*. Beijing: China Statistics Press.

Table 7.3 Average Urban Household Ownership on Selected Durable Goods at Year End 1998

	Motorbike (no. per 100 households)	Bicycle (no. per 100 households)	Motorcar for family uses (no. per 100 households)	Refrigerator (no. per 100 households)	Freezer (no. per 100 households)
PRC	13.22	182.05	0.25	76.08	4.8
Beijing	3.8	221	1	105.4	15.6
Shanghai	1.4	132.6	0	103	2.4
Guangdong	42.48	203.73	0.39	78.59	2.12

Source: China National Bureau of Statistics. 1999b. *Annual Statistics on Retail Prices and Urban Household Income and Expenditure in China 1999*. Beijing: China Statistics Press.

7.3.5 Impact on Chinese Retail Structure in terms of Modernisation

During the author's interviews with the foreign retailers, six companies revealed information on whether they had any net profit at the time. Two retailers reported to have net profit, after operating in China for three years. One retailer stated that they were breakeven. Another retailer claimed that they were close to making net profit. The other two retailers responded that they did not have any net profit yet. These two retailers and the one who was breakeven at the time claimed that the main problem was the overhead costs. Therefore, these two retailers who were not making any net profits said that they needed a total number of five to six outlets in one region in order to have net profit.

Although most retailers interviewed did not make any net profit at the time of interview, they have had made some significant market effect on the retail industry in China. According to the 1999 Market Statistical Yearbook of China, Metro Cash and Carry ranks the fourth among all chain store enterprises with capital of RMB 50 million (US$ 6.02 million) or over in China in 1998 in terms annual sales. With only four outlets at the time, their annual sales in that year reached more than RMB 2 billion (US$ 0.24 billion). In fact, six retailers interviewed believed that they were occupying good market positions in the cities in which they operated. The Chief Operating Officer of Company F claimed that they were having a market share of about 16.5% in the FMCG retailing sector in Shanghai at the time of interview. The General Manager of Company K believed that they were occupying either a first or second position in the retail sector in Beijing in terms of market share, while Company D were occupying a third or fourth position in Guangzhou. The General Manager of the distribution centre of Company L also believed that Company L were having a highly favourable position in the market. Similarly, both the Executive Director, Finance, of Company E and the Manager of the Supermarket Division of Company C alleged that they were doing well and there was not any significant threat of competition.

Due to their high volume of sales and favourable market positions, foreign food retailers have already started to induce changes in the retail industry in China. One impact is that they have changed consumers' expectations regarding services, pricing and quality. They introduced a new experience of food shopping to Chinese consumers. Consumers are made aware that they could now purchase goods of high quality at a low price. Consequently, all the players in the field are compelled to improve the quality of products and services they offer and reduce their prices. As described by the Buying Manger of Company J,

> "Players like Makro and Carrefour are influencing the market. They deal with suppliers everyday and the quantity they are talking about is big. They make a lot of joint promotions with the suppliers. Therefore, they always sell products at a discounted price. Their behaviour has become one of the factors to be considered in pricing decisions in the market. For example, if Carrefour today sells this product at 3 Rmb, it's not long before everybody else follows, because otherwise they are going to lose. Consumers are sensitive to these things. They believe that if Carrefour can sell it at such a low price while the product quality is maintained at a good level, all the other retailers should be able to, and should, do so as well."

Subsequent to the pressure of improving quality but reducing prices, other retailers in the field have to reduce their costs by employing the more advanced information technology and retail know-how that foreign retailers have brought along as they entered China.

However, retail know-how consists of much tacit knowledge, which requires time to learn. This makes true modernisation difficult for many local retailers. As mentioned before, many local retailers have copied the format of foreign retailers'. Nevertheless, there is a difference between superficial modernisation and true modernisation, which incorporates many elements that are beyond the tangible and visible hardware in a store. The hardware of a retail store is build around a concept. The success of a retail business depends largely on a formula that is made up of a delicate balance of different elements, as demonstrated earlier in the present section (section 7.3). Possession of adequate managerial skills in different areas is also essential. As pointed out by the Chief Operating Officer of Company F,

> "To copy is one thing, to do business is another. To do business, you need the experience and management skills. So, copying and being able to run the business successfully is two totally different things."

Similarly, the Chief Non-Food Purchasing Officer of the same company also stressed that,

> "The local retailers who are copying our formats have a long way to go. Even if they hire ten people from our company, they will still not be able to run the business as we can because they lack the experience and skills in helping the staff to develop......For a company to be successful, the people who run it must know every details of the business and the environment in a heart beat. This knowledge and ability comes from experience."

True modernisation of the Chinese retail industry will only emerge after a certain period of time[11].

Some scholars claim that certain selected indicators on retail structure and economic and social environment in the economically advanced countries may be used as a basis for forecasting future retailing trends in the less developed countries (Kaynak, 1988d). In other words, they believe that development of retailing in transitional economies will be a repeat process of what happened in developed countries in the past. Based on the modernisation impact that foreign retailers brought into China, as discussed in the last few paragraphs, the future retailing structure in China might seem to converge towards those in the developed countries and hence those scholars' belief appear to be plausible. However, there are traits that suggest this may not necessarily be the case.

As mentioned earlier, the retail development in China is truncated. The retail and distribution structure before the 1990s was very primitive. In early 1990s, the Chinese government intended to modernise the sector and therefore opened the sector to foreign direct investment. Subsequently, different kinds of modern retail operators suddenly appeared in China. At the time, income level of the majority of the Chinese population remained low. Due to their much higher operating costs than that of the conventional food retail outlets, foreign food retailers had to target the medium to high income earners in China when they first entered and wait for the average disposable income of the rest of the population to increase before they could absorb a wider customer base. The modern retail concepts of foreign retailers are ahead of the economic and social development in China when they entered the market. This situation is different from the retail development in Western countries, in which different retail formats evolve in response to the changes in the economic and social environment. This implies that China nowadays is experiencing a retailing development process that is different from that being found in developed countries in the past. Consequently, the retail structure and the economic and social environment indicators in the economically advanced countries may not be appropriate in predicting the future retail landscape in China.

There is no doubt that the strategic, management and operational elements of foreign retailers will shape the retail landscape in China to a certain extent. Nevertheless, foreign food retailers are also making adaptation to the local environment, which is very different from the European or American environment. Furthermore, the retail development process in the contemporary China is unprecedented in the developed countries, as just pointed out. Therefore, a distinct retail structure may evolve in the future in China.

7.4 Learning-Oriented Culture

The concept of organisational learning orientation is introduced during the discussion of the process model in section 2.1.2.1, where the concept of knowledge is also examined. Process model views internationalisation as a process of geographical expansion enabled by knowledge accumulation. In other words, knowledge is the ultimate source of competitive advantage. In order to accumulate knowledge, an organisation must possess a capability to learn. This tenet lays the foundation of the concept of organisational learning orientation. Having an organisational learning orientation is particularly crucial to retailers because it provides an approach for continuous adjustment of organisation issues and knowledge utilization in a turbulent

[11] The importance of the learning process to a retailer is investigated in the next section.

competitive climate (Kiernan, 1993; Stata, 1994 in Morgan, Katsikeas and Appiah-Adu, 1998). Furthermore, the flexibility inherent in a learning organisation means that rapid company responses are possible in order to exploit emerging opportunities or extinguish threats (Morgan, Katsikeas and Appiah-Adu, 1998). In addition, information usually flows efficiently within learning organisations and this could lead to significant reduction of transaction costs and economies of information (Morgan, Katsikeas and Appiah-Adu, 1998). Retailing is an industry that directly interacts with consumers. With rapid development of technology and intensifying competition, together with rapid changes in consumers' taste, retailers could not sustain their favourable positions in the market without the capability to continuously fine-tune their organisational issues.

For the present study, organisational learning is defined as the capacity or process within an organisation to maintain or improve performance based on experience[12] (Nevis, DiBella and Gould, 1995), and that capacity is termed organisational capability (OC), which is discussed in section 2.1.2.

This section discusses the view that retailers hold on the importance of human resources and how they use human resources to leverage knowledge accumulation for the whole international organisation to improve performance and innovate.

7.4.1 Human Resources Policies

The issues that are examined in this part include the balance between using expatriates and local people, qualification and experience required of recruited local staff, methods of training adopted by foreign retailers for local staff and a brief evaluation of the performance of local staff.

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[12] There is little consensus as to what is meant and understood by the term organisational learning (Schein, 1996b in Morgan, Katsikeas and Appiah-Adu, 1998). Some scholars discuss organisational learning in terms of knowledge and new insights (Hedberg, 1981 in Morgan, Katsikeas and Appiah-Adu, 1998). Some others discuss it at the level of structural priority (Chandler, 1962 in Morgan, Katsikeas and Appiah-Adu, 1998). There are also some who investigate organisational learning by looking at systems and procedures (Jelinek, 1979 in Morgan, Katsikeas and Appiah-Adu, 1998).

7.4.1.1 Extent of Localisation

In order to maintain faithfulness to the original concept without overlooking local sensitivities, multinational firms tend to employ mixed management teams consisting of both local and expatriate executives. No information on the extent of localisation was obtained from Company H. All the other twelve retailers interviewed reported that they tried to localise as much as possible for two reasons. First, using expatriates in China was very expensive, which substantially increased their overhead costs, especially at the beginning of their foreign direct investment. Secondly, the local people had a better understanding of the local consumers' need. The second reason given by the retailers interviewed is in line with the claim of Nakata and Sivakumar (1997), who argue that local people are more capable in reading the local market conditions and understanding local consumers' taste and consumption behaviour. Their main reasons for bringing in expatriates in the first place were to introduce the expertise of their company into their operations in China and to train local staff, who hardly had any knowledge and experience in running a modern retail operation.

All the expatriates in Companies B, I, D, K, F, A, J and E that the author interviewed, who were the top executives, had substantial expertise and experience in the retailing industry in the developed countries. The number of years that they have worked in the industry ranges from five to thirty-four. Some of them even have worked in the industry in many different countries. According to the Chief Operating Officer and the General Manger of Company F, besides possessing adequate knowledge of and experience in the retail industry, expatriates should also be open minded about different cultures, believe in trust and team building and seek to develop the staff members of the company.

> "Expatriates should be open-minded, modest, willing to listen to people, learning oriented, and very importantly, able to work with people but not rule people," said the Chief Operating Officer of Company F.

No information on the experience of the expatriates in the other five companies were obtained.

Companies B, D, K and F revealed that at the time of interview, the proportion of expatriates in their entire work force in China was about 5%, 1%, 5% and 1% respectively. Companies A, J, E, C, M and L also stated that the number of expatriates in their Chinese operations was 3, 2, 4, 7, 3 and 15 respectively. The total number of the workforce of these six companies was not available. However, these six companies claimed that expatriates accounted for a very small proportion of the staff in their companies. Except Company E, all the other eleven retailers disclosed that they had a higher number of expatriates at the commencement of their Chinese business than at the time of interview. Companies B, A, C and L pointed out that they were still actively trying to reduce the number further, whereas Companies D and F specifically claimed that they would maintain the number reported at the interview. The Chief Operating Officer of Company F emphasised,

> "We are not decreasing the number of expatriates here any more because we need to have some expatriates here to make sure that every store is run under the same regulations, instructions and rules so that the 'store culture' is the same for every outlet and our core concept is maintained."

The General Manager of the distribution centre of Company L made a similar remark,

> "Although the Company was still trying to reduce the number of expatriates, the number will only be reduced to a certain point because we need to have the expatriates to make sure our style is implemented and maintained properly in the stores here."

Contrasting the policies of the other retailers, there were less expatriates at the beginning than at the time of interview in Company E. When Company E first started their business, according to their Executive Director, Finance, they wanted to keep the overhead cost as low as possible because they could not afford to lose too much money at the beginning. Therefore, they started off with only one or two expatriates. To solve the problem of finding competent management staff, they employed people at the management level from other retail companies in China, whose salary was lower than expatriates. He claimed that competent human resources for the management level in a modern retail firm was rare but they managed to get enough quality people. He pointed out that these colleagues of his were well trained and were competent in performing their job. Moreover, they possessed the understand of and sensitivity to the local market, including issues related to consumers, competitors and the government. Company E had been having a good development and therefore they could afford to increase the number of expatriates to four at the time of interview. More expatriates were also needed as their business expanded. Nevertheless, the Executive Director, Finance, believed that having four expatriates was optimal for the time being and hence they would maintain the number of expatriates at around that level.

One plausible reason for the difference in the policy of using expatriates between Company E and the other companies is related to their organisational structure. The foreign partner of Company E bought a franchise from another foreign company to develop Company E in China. The foreign partner of Company E was not a grocer retailer and therefore unlike other retail counterparts, did not have a particular retail 'concept' or 'style' to put through in their operations in China when they first entered China. Furthermore, they obtained very good support in every way from their franchiser. Consequently, whether the management staff was expatriates or local was not a significant issue provided that their staff possessed adequate experience and knowledge about modern retailing. Subsequently, their need for expatriates at the inception of their business in China was not as intense as their counterparts. This, together with the budget constraint, leads to a lower number of expatriates in Company E than in other retailers at the early stage of their Chinese operations. Nevertheless, as their retail business developed and became more mature than at the beginning, more expatriates were bought in from the home country to ensure the smooth running of the business.

7.4.1.2 Requirements on Recruiting Staff in China

As mentioned before, the retail and distribution industry in China, as a legacy of the command economy, is under-developed. Therefore, there is a shortage of well-trained and experienced workforce for the retail industry. Furthermore, the concept of service hardly existed under the 'iron rice bowl' system[13]. Consequently, the

[13] Under the communist regime, there was no reward or punishment system for encouraging people to improve performance. Jobs were allocated to people by the government. People would not be laid off for poor performance. This system was termed 'iron rice bowl'.

proportion of workforce with the right mentality for modern retailing is small. Knowing the situation of the labour market in China, foreign retailers tended to relax their usual requirement on the amount of experience one should possess for middle managerial positions. Instead, they emphasised more on other qualities. Based on the discussion with Companies D, K and A, the suitable candidates for middle managerial positions would be those who were open-minded, progressive and with a learning attitude. Companies B, J and G said the suitable candidates had also to be university degree holders. The Vice President of Company B remarked,

> "...knowledge can be taught, experience can be gained, we can train them, as long as they've got the intellectual potential and are with the right mentality."

Actually, the General Manager of the distribution centre of Company L claimed that he preferred to employ people with no experience in the retail and distribution field in China because that would guarantee that their employees did not have "bad habits". He alleged that the "practice" for the buyer on the retailer side to receive commission from the seller on the supplier side had been very common within the local distribution channel in China, which was a "practice" that they did not want their employees to adopt.

7.4.1.3 Training

No information relating to training was obtained from Companies C and M. Therefore, the discussion in this particular section is based on the information obtained from the other eleven retailers.

Due to the lack of well-experienced retail human resources, foreign retailers recognised training for local staff as very important. Based on the interviews with the retailers, there were four main forms of training: in-house training courses, sending staff to their operations in home or other countries, bringing in trainers from their home countries and using external training agencies.

All of the eleven retailers claimed that their retail corporation had very well-developed training materials and resources for them to carry out training for local staff in China. According to the General Manager of Company K, the training they provided for their managerial staff was very comprehensive, which included customer care training, different management training, selling skills training, buying training and negotiation training.

Nine of the above eleven retailers also sent their local staff who occupied higher managerial positions to their operations in home countries or other developed countries as part of the training. If the staff was sent abroad for a very short period of time, such as a week, they were required to visit the operations to learn how the whole system worked. If they were sent abroad for a longer period of time, such as half a year, the activity would be similar to a proper placement. These activities were meant to be practical sessions for the staff to learn in the real environment about what their retail system is all about. The duration of the visit depended on the position of the staff. Normally, it would be longer for staff at a higher managerial level. In Companies A, J, E and L, who are Asian companies, the visits usually lasted for a week or two. In Companies B, I, D, K and F, who are European companies, the visits could last up to eight months. The situation with Company E was slightly different. They sent their Chinese staff who occupied very high managerial positions to the country of origin of their franchiser to learn about their retail concept and system by visiting their franchised stores. In order to train all other Chinese staff. Company E sent a few key people to the Asian headquarters of their franchiser to learn about their retail concepts and systems so that they became trainers when they got back to China for all the other staff. They termed it "train the trainers programme".

Company H used to place some key staff in their headquarters' operation but they had stopped it when they had successfully arranged with Wal-Mart to let their staff visit and learn in Wal-Mart's stores in Southern China, which saved much cost for Company H.

Company G had planned to send some higher managerial staff to their headquarters at the beginning but they abandoned the plan because their country of origin had very strict policy in approving entries for people from China.

On the other hand, Company A and D claimed that obtaining a visa to go abroad was not easy for their Chinese staff and therefore they had to incorporate this consideration in deciding their training plans. The President of Company D pointed out,

> "Chinese people have difficulty in travelling. There are restrictions on their travelling. So, it is not a question of what we decide to do. I tried to send people to Singapore, and it ended up we could not, because they did not have the visa. So, all we could do at the end was to give seminars to them here, in China."

The third form of training that was used by foreign retailers is seminars held by visiting colleagues from outside China. This method was not popular among the retailers interviewed. Only Companies I, D, E and K adopted it and they only did it occasionally. Furthermore, the visiting colleagues only stayed for a few days each time.

Apart from the three forms of training as discussed above, Companies J and K claimed that they sometimes also put their staff on specific courses run by external training agencies.

Seven retailers specifically pointed out that their local staff "picked things up very quickly". Six of these seven retailers were generally happy with their staff's performance, although two of them revealed some little problems with their staff. The General Manger of Company F found that the behaviour of Chinese people was difficult to understand sometimes and therefore he had to "check things out himself to make sure everything was right". The President of Company D claimed that their Chinese staff were not very used to working in a company of their scale, in which there was tremendous amount of details that staff had to look into, and therefore he had to put some extra effort in making sure all the details were attended to. On the other hand, one of those seven retailers, Company L, alleged that they were not very satisfied with the performance of their Chinese staff, although they learnt quickly, because their performance was not of a high enough standard and they still had a different mentality towards retailing. The General Manager of the distribution centre of this company attributed this problem to the fact that they had no control on the recruitment of staff[14] and he felt that their Chinese partner did not recruit exactly the kind of people they wanted.

7.4.2 Importance of Human Resources in a Retail Company

In response to the author's question of their views on the importance of human resources to a retail company, all nine retailers with whom the author had discussed this issue replied that it was very important. They used words/phrases such as "vital", "very important", "almost the most important" and "the most important". The Vice President of Company B replied,

> "Human resources is vital. It's people who make a company different. Our people make the difference. Our people are among the best trained in the industry...The most important element for our successful retailing in China is our people."

Similarly, the General Manger of Company I stated,

> "Human resources is a very important element that gives rise to our long term and sustained success and therefore we put a lot of emphasis human resources training everywhere we go."

In the same vein, the Buying Manager of Company J believed,

> "Human resources is very important. It's central. Our people are our important assets."

In fact, their emphasis on the importance of human resources to the success of a retailing company is also reflected in their human resources policy that is discussed in the previous section. Their rationale for believing in the importance of human resources was that retailing was about serving customers and how they could serve their customers significantly depended on their people because successful retailing involves the accumulation and effective utilisation of tacit knowledge. This tenet is most obviously implied in the responses of the Chief Non Food Purchasing Officer of Company F and the Buying Manager of Company J. The Chief Non Food Purchasing Officer of Company F described,

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[14] This is because it was agreed in their joint venture agreement that the Chinese partner controls staff

> "Basically, we (Company F and our competitors) sell more or less the same merchandise, and the price competition is already down to the bone. There is no more meat left. And the thing that makes differences between different retail organisations is human resources: what type of people have you got? How do they perceive and understand your concept? How they react to market changes and how they serve the customers? These are the most important issues."

The Buying Manager of Company J pointed out that,

> "Hardware and systems can be taught. Everyone can see the tangible elements and it is not that difficult to put up the whole store with the same hardware and system. However, if you want to be a successful retailer, you must have the human resources who have got a vision about what is going to happen in the market in a year, two years, five or so."

What the Buying Manager of Company J referred to as "vision" is the tacit part, which can only be acquired through experience of individuals. Different individuals perceive the same concept differently and they have different sensitivity to the market situation. A successful retailer requires human resources that are capable to flexibly apply its core concept to different market conditions. This again, is tacit and experience and time are needed for an individual to acquire this capability through a learning process. This tacit element of retailing is the ultimate element that gives rise to sustained competitive advantage of a firm in the especially dynamic retail market. This is the reason why retail firms put much emphasis on developing individual expertise in their organisations.

In the learning process, one crucial element that has to be cultivated is market orientation[15 & 16]. As stressed by the Chief Operating Officer of Company F, "...the

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recruitment.

[15] Market orientation, based on marketing concept, has been advocated, criticised and defended since the 1950s (Felton, 1959; Liu, 1995 in Appiah-Adu, 1998). It is considered to be a cornerstone of marketing thought (Morgan, Katsikeas and Appiah-Adu, 1998). However, a review of relevant literature reveals that relatively little is understood of the ingredients of this theoretical construct (Deng and Dart, 1994 in Morgan, Katsikeas and Appiah-Adu, 1998). During the late 1980s, advances in this area were made and efforts were directed towards determining the conceptual domain, scope, interpretation and measurement of market orientation.

[16] Since the late 1980s, two conceptual frameworks of market orientation have been dominating the marketing and strategy literature. The first one is advocated by Slater and Narver (1995) who define market orientation as "the culture that places the highest priority on the profitable creation and maintenance of superior customer value while considering the interests of other stakeholders and [it] provides norms for behaviour regarding the organisational development and responsiveness to market

main point is to get our staff customer-oriented..." Market dynamics have a significant impact on the effectiveness of strategic orientation (Snow and Hrebeniak, 1980; McKee *et al.*, 1989). Consequently, firms must continuously monitor and act on their external environment (Houston, 1986; Kohli and Jaworski, 1990). In fact, a positive relationship between market orientation and a firm's return on assets (ROA), which is one way to measure performance, has been demonstrated in various studies carried out in some developed countries such as the US (Narver and Slater, 1990; Ruekert, 1992; Jaworski and Kohli, 1993; Slater and Narver, 1994, 1995) and the UK (Pitt *et al.*, 1996). Furthermore, evidence also exists in the literature that shows a positive association between a firm's level of market orientation and the realisation of organisational or performance objectives, although it may take years for this positive link to emerge or it may be hidden in yearly fluctuations (Appiah-Adu, 1998).

7.4.3 Organisational Learning

Organisations ultimately learn via the individual learning processes of their employees (Kim, 1993). When a foreign food retailer launches its operation in a new country, adaptation is necessary due to cultural, socio-eocnomic and technological

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information" (p.67). The other one is proposed by Kohli and Jaworski (1990). They operationalised the implementation of the marketing concept as market orientation, which they define as 'the organisation-wide generation of market intelligence pertaining to current and future customer needs, dissemination of the intelligence across departments and organisation-wide responsiveness to it' (p. 6).

These two perspectives are complementary to each other and share certain similarities. First, they both maintain that customer is central to the manifestation of market orientation. Secondly, they both balance an internal and external business view of the specific environment situation. Thirdly, they both express an explicit sentiment that the whole firm should respond to identified customer needs. Lastly, they both suggest that the scope of market orientation goes beyond customers and incorporates competitors or the forces shaping customer needs such as technology and regulation.

Despite these similarities, there are fundamental differences between the two perspectives. Kohli and Jaworski's perspective focuses on the activities and behaviours that underlie the generation and dissemination of market intelligence and the associated response by all parties within the firm. On the contrary, in addition to including behavioural elements within their conceptualisation of market orientation, Narver and Slater's perspective also embrace a cultural perspective in their discussion. They suggest that specific activities involving information processing are a natural product of market orientation instead of the orientation per se and accordingly, they define market orientation as the organisational culture that creates the essential behaviour for the generation of superior value for customers and on-going superior performance for the business in the most effective and efficient way (Narver and Slater, 1990).

differences. Adaptation is a learning process of individual employees that bridges the gap between the existing knowledge of the retail organisation and the knowledge required to appropriately serve the new market. In order to fully utilise this new knowledge that individual employees in the overseas operation acquired so that it could be further assimilated to enhance the performance and growth of the whole retail organisation, it has to be transferred from the individual employees to the whole organisation. In other words, knowledge of individual members has to be integrated through some mechanism in order to give rise to certain organisational capability. This process is crucial to a retail organisation. The remark of the General Manager of Company K provided an illustration of this point,

> "Our corporation have specialists in almost all areas in retailing, such as purchasing and new store construction. They are responsible for all international projects. These specialists have very close contact with operations all over the world. They continuously accumulate experience in different countries, both developed and developing. Consequently, they continuously develop new retail expertise. As a result, they give very strong support to subsidiaries anywhere in the world. This support is crucial to the international expansion of our company."

The integration of knowledge can be achieved by knowledge sharing within the overseas operation unit and within the whole retail organisation. This can be done formally or informally.

The author was only able to briefly discuss knowledge sharing with eight retailers. According to them, a large part of knowledge sharing was achieved through informal communication among colleagues, both within the Chinese operation unit and within the whole retail organisation. Simultaneously, there are also designated meetings that were held regularly to gather colleagues from different parts of the world to share their knowledge and experience. For example, according to the Managing Director of Company C, meetings were held three to four times a year by and at their Asian headquarters so that managers from different departments and different stores met up and shared their experience. Similarly, the Chief Operating Officer of Company F stressed that board members of operations in different countries met up regularly to talk about their experience, which he thought was vital to the long term growth and success of their retail organisation.

Sergeant and Frenkel's (1998) advocate that individual learning can be better captured for organisational learning by having returned managers from a particular country undertake more active roles in managing or supporting current expatriates in that country. The current study found that most retailers interviewed understood the importance of using their experienced member in developing new operations and were putting this understanding into practice. For example, the General Manager of Company K, who had rich experience in the retailing industry in different countries, was a key expatriate in their operations in China. He stated that,

> "I have been working in many subsidiaries of our corporation in different countries and my past experience is always very helpful when in new operation development in a new country."

Another example is Company F. Their Chief Operating Officer had been in the industry for more than thirty years and had extensive work experience in many different overseas subsidiaries of their Company. He stated that he had already reached the age of retirement but he chose to carry on helping the company to expand and develop in different countries because his experience was very valuable. In fact, as shown earlier, many of the expatriates in the retail companies in the present study were all well-experienced in retailing in more than one country.

From the above discussion, the reader may question that foreign food retailers do not seem to have any formalised mechanisms to incorporate all the knowledge that individual members acquired. As argued by Kim (1993), when an individual does not codify the learning through systematic data gathering, analysis and standardisation for later use, situational learning occurs and this makes organisational learning incomplete. However, the author would like to draw the attention of the readers to the fact that a large part of competitive advantages in retailing comes from tacit knowledge, as discussed earlier. By its own very nature, tacit knowledge cannot be codified in the way claimed by Kim. Moreover, heavy codification requirement may lead to distraction to employees' focus on being alert and sensitive to changes in the retail environment. Consequently, the author would argue that in the retail industry, heavy investment in training and developing capable human resources, and cultivation of a learning oriented culture are significantly more important than codification of the learning process.

7.4.4 Incorporating Learning Orientation into Corporate Culture

According to Schein (1992), culture is a pattern of shared basic assumptions that a group learned as it solved its problems of external adaptation and internal integration, and has worked well enough to be considered valid and hence desirable to be taught to new members as the correct way to perceive, think and feel in relation to those problems. Corporate culture, therefore, is how an organisation has learnt to deal with its environment. It is a complex mixture of assumptions, beliefs, behaviours, stories, myths, metaphors, company symbols, rituals, routines and other ideas that fit together to define the norm in a particular organisation. It provides a framework that guides daily behaviour and decision making for employees and directs their actions towards the achievement of company goals.

Garvin (1993) strongly believes that the right corporate culture must be created if knowledge is to be acquired, assimilated and utilised in a constructive way to the corporation on an on-going basis, because behavioural change is required for learning. Sharing the same belief, Nevis, DiBella and Gould (1995) also argue that the nature of learning and the way in which it occurs are determined by the organisation's culture, which is manifested in forms such as shared insights and organisational routines. Furthermore, organisational structure and management style also influence the type of experience that individuals contribute to the organisation (Kim, 1993).

In the context of foreign direct investment in retailing, the overseas operation unit inherits the corporate culture of the parent retail organisation in three ways. First, expatriates who share the corporate culture of the organisation bring the culture along with them when they develop the overseas operation. Secondly, they would normally recruit people with the mentality that suits their corporate culture. This way, the culture is reinforced. Thirdly, training of local staff further consolidates the culture. Therefore, expatriates play an important role in determining the culture of an overseas operation, which in turn, according to the discussion of in the last paragraph, significantly affects the learning capability of the operation. Consequently, expatriates of a retail firm must believe in the tenet of learning in order to create the right culture for organisational learning to take place. In fact, as discussed in section 7.4.1.1, most expatriates who the author interviewed appear to have strong emphasis on learning and firm belief in a learning oriented culture. Company A is one example,

> "It's our group culture to share information, resources and experience and to learn from each other," said the Director.

Furthermore, the relationship and structure between the overseas operation units and their headquarters in the home country is also significant in determining the learning capability of the overseas unit. Tordjman and Dionisio (1991) claim that when a retail firm does not delegate much autonomy to its overseas unit, the role of the manger of the overseas operation is mainly to ensure the rules and procedures laid down by the parent firm are followed. In other words, the unit is a passive observer of rules and regulations and is only left with the function of information collection. No knowledge is generated. Moreover, as the headquarters locates so distant from the local market, it is difficult for it to efficiently and effectively process and assimilate the information about the local market that is acquired by the overseas unit. This renders the overseas unit vulnerable to changes in consumers' tastes and pressure from competitors. This leads to an inability to take the particularity of local market into consideration. Therefore, a very centralised decision making structure between headquarters and overseas units in the retail industry is not conducive to organisational learning, both in the overseas unit and the retail corporation as a whole. This, in turn, is detrimental to the competitiveness of a retailer.

> "The market is here in China, which is very different from other markets. Therefore, it is difficult to use the headquarters located away from the market to give instruction because the decision makers must have the first hand market knowledge."

Following this whole line of argument, headquarters must delegate much autonomy to their overseas operations, especially in the development phase of FDI, to create a conducive environment for organisational learning and hence increase the learning capability of the whole retail corporation.

The present research found that all the foreign retailers interviewed had much autonomy to run the retail units in China and at the same time obtained all the supports they needed from their parent firms. As the General Manager of Company K described,

> "We have got good support from our headquarters for whatever we need and whenever we need, but we also have the autonomy that we need to run the business here competitively."

Similarly, The President of Company D stated,

> "I think I've got quite a lot autonomy. I am happy with the freedom I have for my work. That's the culture of the company as a whole...The culture is that we have a very small central head office. We don't have an army of people there. People like myself are given a business to develop, grow and run in different countries. We get on and we do it. The head office is involved mainly when finance is concerned. We have a lot of autonomy."

In fact, according to the more detailed discussion with Companies B, D, F, A, J and L, their headquarters were also only involved in decision makings related to the more important strategic issues such as plans to open new stores and budgeting.

The high autonomy delegated to the retail operations in China by their headquarters in the present cases might be due to the fact that there is a very large cultural difference between their the Western countries and China. Because of this cultural distance, the headquarters may feel that they do not know much about China and their investments in China carry an experimental nature. Consequently, they are willing to delegate much autonomy to their Chinese operations.

Kim (1993) argues that very decentralised organisations that do not possess the networking capability to keep different parts connected are susceptible to fragmented learning. In the cases of the foreign retailers in the present study, they had high autonomy but yet their retail organisations as a whole were not susceptible to fragmented learning. This is because their headquarters, although giving them a free hand, maintained very close connection with them (according to most of the retailers) and played an important role in managing and utilizing knowledge and experience accumulated in different overseas operations. As pointed out by the Vice President of Company B, "Our parent company provides knowledge and information about other markets." The Buying Manager of Company J also stated that "As a whole company, basically, our parent provides transfer of ideas and experience." By undertaking the role of knowledge organiser, the headquarters are able to provide very strong supports to their overseas operations, which enhance the competitiveness of the overseas operations. The respondents from Companies B, D, K, F, E and L stressed that they obtained very good support from their headquarters in any aspects that they might require for establishing and running the business in China.

To summarise, the retail industry appears to be an industry that stresses the importance of being a learning-oriented organisation because their long term success largely depends on their ability to make continuous adjustments to match with their environment. In order to generate an organisational capability, they invest heavily in training and value their staff as important assets to the company. Furthermore, a learning oriented culture seems to have been deeply planted in many international retail corporations.

7.5 Conclusion

This chapter investigates the complicating issues that foreign retailers faced when they transferred their retail expertise from their home country to China. In China, transportation and electricity infrastructure is not well developed. The concept of distribution and the norms and practices in the distribution channel in China are very different. Consumer literacy is low. Lifestyle and eating habits of Chinese people differ significantly from those of the people in Europe or the US. Chinese socio-economic indicators have not reached the level of those in developed countries. Reliable information concerning the consumer market is not widely available. There is also a lack of well-experienced human resources for the retailing industry. All these factors affect the extent to which the origin retail concept and expertise are applicable in the Chinese environment. In order to overcome the differences, retailers must possess the sensitivity to local retail environment and make adjustments accordingly. The balance between maintaining certain core constructs and adapting to the local environment is delicate. Fine-tuning an original retail system without losing the core competence requires both experience in the industry and a thorough understanding of the market situation[17]. Expatriates possess tremendous experience and expertise while local people possess better market knowledge. Consequently, intensive training programmes are provided to local employees by the foreign retailers so that the local staff can be taught the core explicit knowledge about their own retail system. Furthermore, the local staff also acquires the tacit knowledge of retailing as their hands-on experience increases. The cultivation of a corporate culture with a learning orientation effectively facilitates the whole learning process. Simultaneously, expatriates are also learning about the Chinese market as time goes. With a mixed effort, a retail formula that suits the Chinese market best is anticipated to evolve. In fact, the last decade was a valuable time for foreign retailers to learn about the Chinese market, develop competent human resources in China and test out the their concepts because competition was not too intense.

On the other hand, this chapter also demonstrates that the factor that ultimately derives a difference for a retailer and hence gives rise to competitiveness is organisational capability. A culture with emphasis on learning has to be started from the headquarters and carried over to all the overseas operations in order to maximise organisational capability. Furthermore, experience and knowledge accumulated and assimilated at each overseas operation has to be shared among the entire retail organisation. The headquarters is in the best position to act as an organiser for knowledge sharing.

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[17] There is one point that should be noted. Formation of perception involves a complicated interaction of influences. When decisions on adjustments are made in a retail operation, human factors are involved. The type of decision that is made is affected by the experience, perception and background of the personnel who are concerned. This area is not studied in the present research because it is beyond the scope of the thesis. However, there is a need for more detailed studies to ascertain how the experience of a retail manager influences his decision making on adjustments in a particular country.

Chapter 8
The Synthesis

The study investigates the critical variables in the process of foreign direct investment in retailing and develops a framework to help understand and explain the phenomenon. In its entirety, the research reveals some fundamental behavioural differences between retail foreign direct investment and manufacturing foreign direct investment. Such discovery has theoretical implications in the retailing and international business disciplines, and business implications for food retailers that want to expand into China and countries that share similar political and economic characteristics. Before discussing these implications, an overview of the key issues of this study is presented and the section closes with suggestions made for further research.

8.1 Overview of Key Issues

8.1.1 Motivation Behind Retail Foreign Direct Investment

With respect to the long-term strategic objectives behind retail internationalisation, the findings of the present study pose challenges to the reactive school of thought and the psychic distance concept, and furthermore suggests that the proactive school of thought does not fully explain why retailers engage in FDI. The empirical work shows that a significant number of the retailers studied were very proactive. They expanded their operational domain well before their home countries had become unfavourable for retail investment. Furthermore, none of the retailers in the study had stopped domestic investment after they went abroad. This further renders the reactive school of thought unsuitable. On the other hand, the proactive school places too much emphasis on the pull factors in host countries. Based on the empirical work, it appears to be more suitable to treat these as the determining factors that a retailer uses in selecting the host countries, instead of being the reasons for retailers to engage in foreign direct investment.

The reasons behind retail internationalisation, as the present study reveals, are related to the retailers' long-term strategic objective of growth in market power, both horizontally and vertically. Owing to significant global changes in trade policies and political climate in the last two decades, national boundaries no longer pose strict confines to the expansion of a retailer. At the same time, it also means that national boundaries provide no more shelter for local retailers. No one is safeguarded from being forced off the playing field by large-scale retailers from another country. Under such circumstances, size does matter. Middle size retailers who have a strong market share in a certain country but little international spread are the most vulnerable in the acquisition game. Small size retailers, on the other hand, lack competitiveness because of cost problems. Therefore, in order to survive, retailers strive to increase in scale by both domestic and overseas expansion. There is no denying that growth through merger and acquisition can take place at a quicker pace than organic growth. However merger and acquisition requires a suitable acquiree, which is not easily found. Consequently, organic growth is still a popular and useful way for retailers to expand and increase their market share on a global scale.

By increasing horizontal market power, retailers can also drive cost down by having greater bargaining power over their suppliers, which in turn gives rise to lower costs incurred in merchandising. By so doing, retailers can offer consumers better value for money, which is important in competitive survival. Despite the popularity of the tenet of collaboration between vertical channel members to create a 'win-win' situation, this study discloses that the struggle for control and bargaining power still heavily underpins the buyer and seller relationship. Building up trust and long-term relationships between partners in the channel is important because their ultimate customers are the consumers. However, issues related to control and bargaining power should not be overlooked.

Horizontal and vertical market power are closely intertwined and mutually reinforcing. In order to achieve high profits, a food retailer must simultaneously possess strong bargaining power over their suppliers and a large market share in the consumer market. In fact, it is this desire to achieve such a position that drives retailers to expand their domain of operation.

The majority of the retailers interviewed chose to enter China because of its huge population, remarkable economic development, and because the market was largely untapped. Considering all these factors, China possesses tremendous potential and this was what prompted the entrance of food retailers, once they were allowed to do so. As the market also offered significant retailing space, China, during the last decade, has provided a testing ground for the retailers to learn about the market and experiment with the formats that would best suit it.

Sourcing is found to be an important secondary factor in retailers' decision to choose China. The low cost of production makes China a good source of merchandise for retailers all over the world. Co-location of retailers and manufacturers offers benefits to both parties in terms of knowledge of requirements and working practices, and improvements in the standards of locally manufactured products. In other words, foreign direct investment in China is a means by which retailers can obtain a more reliable supply of products, from china, for their operations in other parts of the world.

A few cases revealed that sentimental attachment is also a secondary reason why some retailers went into China.

By tracking the chronological order of the countries which the retailers entered, this study has produced enough evidence to suggest that the psychic distance concept about retail internationalisation does not seem to capture the pattern in reality. Retailers appear to be more ad-hoc in the choice of host country. There is no denying that a country has to have passed the test on certain economic, demographic and political characteristics in order to be considered by a retailer. However, in reality, the sequence seems to be more related to how the management of the company feels about a country. The discovery of sentimental attachment as a secondary reason behind retailers' entry into China is one example. The choice of host country appears to be more contingent on the country knowledge that the personnel in the management of a company possess. This familiarity of the management to a particular country is unquestionably a manifestation of psychic distance. Nonetheless, the difference between the argument of the present study and that of the psychic distance concept is that the present study argues that there is no objective way to measure psychic distance, and hence predicting which country a retailer will approach next is difficult. Furthermore, even if there is a pattern of the internationalisation process of retailers, the present research shows that cultural studies such as Hofstede's offer little help in the explanation of this. Therefore, this study proposes that the pattern of retail internationalisation is more complicated than what the psychic distance concept and the process model suggest.

8.1.2 Market Entry Issues

Regarding market entry issues, one main hurdle that a host country poses to a foreign retailer is its legal and regulatory infrastructure. Inherent in the under-developed legal and regulatory infrastructure in China are three main problems that foreign food retailers considered significant: inconsistency in policies and differences between international legal practice and Chinese legal practice; tight control on foreign retail activities; and discriminatory practices by legal authorities towards foreign retailers.

Based on the study, one way to alleviate these problems is to use both Chinese and foreign lawyers as legal consultants. Chinese lawyers are needed because lawyers from any other country cannot represent clients in courts in China. Foreign lawyers are needed because they understand international legal practice, which foreign retailers are accustomed to. Hong Kong lawyers are well positioned to advise foreign retailers on legal issues in China because they have a very good understanding of both international and Chinese legal practices.

Foreign retailers require a high degree of managerial control over their business in China for two main reasons. Firstly, they need the ultimate decision making authority so that they can put through their system, concept and know-how, which in turn can minimise dilution and degradation of their company brand equity. Secondly, they need the ability to control the strategic direction of the business in China so that joint ventures in China can be aligned with overall strategies and long-term goals on a global scale, such as international supply strategies and global expansion. This is very important because as mentioned earlier, it is the attainment of both oligopsonistic and oligopolistic positions that generates maximum rent for retailers. If they are unable to integrate joint ventures in China with overall organisational strategies, they will be unable to fully capture the advantages that their foreign direct investment in China can offer.

In addition to this need for maximum control, possessing a good *guanxi* network in China is also essential. Moreover, by law, wholly-owned foreign subsidiaries were not allowed in China at the time of the study. Consequently, the best arrangement was to develop a joint venture with a Chinese partner who is not a retailer, is willing to accept little managerial control, and has very good connections with different stakeholders of a retail business in China. This arrangement facilitates the establishment of good relationships between foreign retailers and the government authorities in China. The possession of *guanxi* with government officials is very important in a country in which the institutional environment is pervasive, dynamic and uncertain, and where the legal system is not well developed. Establishing *guanxi* requires a considerable amount of effort and time. Moreover, it requires a good understanding of the Chinese culture. Therefore, foreign retailers are not in a position to master the art of *guanxi* building in China within a short period of time after they entered China. Consequently, the *guanxi* network of their joint venture partners becomes crucial to the smooth development of their business in China. In fact, the majority of the foreign retailers interviewed pointed out that the major contribution of their Chinese partner was their *guanxi* networks with both the government authorities and other relevant stakeholders. The empirical work indicates that no major conflicts between partners were found in retail joint ventures in which the foreign retailers practised dominant parent management. In other words, in cases that a joint venture partner has to be taken for reasons other than management input, dominant parent management appears to be a good arrangement.

The finding that foreign retailers preferred to acquire a majority stake in joint ventures also reveals that their underlying rationale is not about safeguarding against the opportunistic behaviour of their joint venture partners as suggested in most of the current literature. The underlying reason, in fact, is to pursue maximum exploitation of their core competence in order to generate rent.

Site selection and store development is another area in which retailers have to go through complicated procedures. The empirical work found that food retailers basically used the same set of criteria in choosing a site for their store development regardless of which country they were in. Nevertheless, statistical and market information required for the assessment of potential sites are not widely available. Consequently, some retailers pointed out that their site selection process in China involves a considerable amount of "guessing". In other words, the science that they applied in other developed countries was not directly and completely applicable to the cases in China.

Moreover, land is still strictly controlled by the government. The administrative process for a foreign retailer to obtain land is onerous. The land system in China and its legal structure is reviewed and discussed in the thesis. In general, foreign retailers can apply for granted land use right for 30 to 50 years through negotiation with the relevant government authority. Apart from getting the land use right, foreign retailers also need to go through a bureaucratic process of getting approval for site development and construction projects, which includes building design. According to some studies by scholars outside China, the Class 1 Chinese contractors[1] are of world class standard. Nevertheless, the study reveals that they are not very experienced in retail construction projects. As foreign contractors are in essence not allowed to carry out construction projects in China on their own, one solution is to use local branches of Hong Kong construction companies who have rich experience of building retail complexes.

[1] In China, contractors are classified into different classes that define the scale and type of construction projects that they can undertake (Walker, Levett and Flanagan, 1998).

Political opposition from local interest groups was experienced as foreign retailers entered and expanded in China. The form of opposition ranged from informal lobbying to local authorities, to the spreading of negative propaganda about foreign retailers. The retailers interviewed claimed that such opposition did not have any material effect on their business operations. Moreover, they reported that their good relationships with local authorities also helped guard against malicious disturbance by local opposition groups. Most foreign retailers in the study claimed that they established good relationships with governmental authorities through holding seminars and arranging training for government officials who were in charge of the retail and distribution industry, and by sponsoring community events.

Disregarding the legal and regulatory hurdles they experienced in China, the retailers studied appeared to be very bullish about expanding into other provinces in China, especially into the western part of China. China successfully became a member of WTO in December 2001. This brings the promise of further relaxation in foreign direct investment policies in the retail and distribution sector. The legal system as a whole will also be improved, and economic and political reform will most probably be pushed even further. All these changes should make the expansion of foreign retailers in China easier.

8.1.3 Retail Operational Issues

On the subject of operational issues concerning food retailing in China, an analytical framework of international transfer of retail know-how is proposed[2], in which there are three elements: retail technology, retail concept and format, and corporate culture. The first element consists of systems, methods, procedures and techniques. The second element consists of the physical features of a retail store that are visible to consumers. The third element is the culture that underlies the whole retail organisation, including the headquarters and all its subsidiaries.

During the transfer of those elements from one country to another, adaptation is needed in some areas because market conditions vary from country to country. The

[2] Section 7.1.

study uncovers several major differences in the retail environment between China and the majority of developed countries that foreign retailers have experience of. These differences are categorised under supply chain management, retail format and formula, and human resources issues.

In terms of supply chain management in China, there are many tiers in the distribution channel. This characteristic makes direct dealings between foreign food retailers and manufacturers in China difficult. Furthermore, the quality of merchandise supplied by suppliers in China is not consistent. This is especially the case for fresh food products because cold and chilled chain facilities are not common. Therefore, strict control of the quality of products at the receptions departments is necessary. In addition, the distribution system between different provinces is not well co-ordinated and the transportation infrastructure is poor in China, although the situation is improving. These conditions hamper the efficient movement of goods in China from manufacturers to retailers. Moreover, the heavy involvement of the army in the transportation industry in China encumbers a rapid transformation of the industry, despite several foreign investors having already entered the market.

The level of computerisation in China is low. The retailers interviewed found difficulties in raising the level of computerisation of their local suppliers. The major reasons are that most local suppliers lack the financial capability to invest in technology, and they do not have a thorough understanding of the advantages they could benefit from by investing in such technology. International companies in China who have the resources to introduce high technological equipment and systems in their supply chain management are also unwilling to invest in such technology for the time being. This is because the aggregate scale of retailers in China who have the capability to participate in such technology introduction is not large enough to justify the investment. In other words, category management hardly existed in China at the time of study.

In general, the foreign retailers interviewed perceived that multinational manufacturers possessed stronger bargaining power, and hence were less flexible, than local manufacturers and suppliers with respect to the terms of purchase. In other words, foreign retailers could exert a higher influence on the local suppliers than on the multinational manufacturers during their interactions. However, local suppliers were not as reliable as multinational suppliers in terms of quality and reliability of product supply. The choice then depended on the risk preference of the company. Some retailers interviewed did express serious consideration in developing relationships with some local suppliers and carry out joint product development with them.

In terms of retail format and formula, the study reveals that core retail know-how must be preserved whereas adaptation should be made on the peripheral know-how. Core know-how is the source of core competence of a retailer and therefore must be preserved. Peripheral know-how, however, must be adjusted to suit local conditions and consumer tastes and demand, which display differences in different markets. Core know-how is the generic element of a retail firm no matter where it goes. Concepts and expertise on cash flow management and stock turn are two examples of the core know-how of a retailer. When the retailer undertakes foreign direct investment, core know-how such as these two examples should perpetuate. Nevertheless, the question of how to achieve, for example, the stock turn they desire in the host market requires an appropriate adjustment of the peripheral know-how such as merchandising, pricing and store ambience to suit the local consumer demand. It is difficult to define what is core and what is peripheral because they are different in different retailers' mind. Nevertheless, it appears that core retail know-how tends to encompass the intangible concepts or ideas of a retailer, whereas the peripheral retail know-how has more to do with the retailing mix.

The balance between preserving certain know-how and adjusting other dimensions is very delicate. It is in fact a learning process that evolves as a retailer accumulates both tacit and explicit knowledge about a particular market through hands-on experience. Readers should note that the tenet of preserving certain core know-how does not restrict the emergence of new retail concepts because the dividing line between the peripheral know-how and the core know-how is very fine and dynamic. Moreover, the emergence of new retail concepts is an evolutionary process. The study shows that some retailers perceived that their operations in China in the last few years were exploratory in nature, and reported that they were actually in the process of searching for a retail concept and format that would serve the Chinese market best.

In terms of human resources issues, the study finds that all retailers interviewed placed large emphasis on the development of their personnel at all levels. Expatriates with rich experience were relocated to China to develop the business. They were given significant autonomy in formulating their operational strategies. This is probably due to recognition by the headquarters of the importance of tacit knowledge to the success of retail foreign direct investment, especially in a market such as China, where the market characteristics are perceived to be very different from the Western countries. These foreign retailers recognised the importance of developing their local workforce to become capable of assuming increased responsibilities. They offered rigorous training, both courses and on the job training, to their local employees in China, who lacked knowledge and experience of the retailing industry. As a whole, a learning-oriented culture throughout the whole retail organisation, from headquarters to subsidiaries, is crucial to the success of a retail firm. Within such a culture, the headquarters play an important organising role in facilitating knowledge exchange and utilisation throughout the entire organisation.

8.2 Theoretical Implications

A holistic picture that carries an important contribution to knowledge in the field of international business and international retailing emerges when all the issues that this study uncovered are combined together. The study demonstrates that foreign direct investment in retailing is significantly different from that in manufacturing, and that theories of foreign direct investment developed from manufacturing international business are unable to fully capture the essence of foreign direct investment in retailing.

The literature in international manufacturing operations is much concerned with the economic rational of relocation of the production function in different countries. By contrast, when food retailers engage in foreign direct investment, they establish almost a completely new value chain in the host country. This is because sourcing merchandise from within the host country is inevitable due to cost concern and heterogeneous consumer tastes. A large part of knowledge accumulation and utilisation also occurs at the subsidiary level because the majority of the retail knowledge is tacit and a strong consumer-orientation and rapid response to market needs and changes are crucial to food retailing. Establishing and managing a new upstream distribution channel in the host country, and having the responsibility to absorb and utilise knowledge and to adapt in terms of operational strategies in the host market are therefore central to the overseas operations of retailers, whereas this is not necessarily the case for manufacturers.

Consequently, the scope and scale of the interface between a foreign retailer and its host country is generally more extensive and more complicated than that between a foreign manufacturer and its host country. International retailers can be perceived as being made up of many different individual overseas operations each of which has its own value chain, both upstream and downstream in the host country, and chooses the strategy that best suits the local market. Each of these overseas operations are only inter-dependent and inter-related with each other in the sense that the headquarters control the overall business strategy and direction of the entire organisation, financial resources and cash flow, and real estates development. The headquarters also provide information technology to the subsidiaries and sometimes organise some of the activities in the value chain of the overseas operations. Each of these overseas operations are also inter-connected in that knowledge accumulated by each overseas operation is shared among the entire organisation in order to improve the performance of the entire organisation and catalyse innovation in retail concept and format.

Because of this structure, an international food retailer is not as heavily dependent on any particular overseas operation in comparison to an international manufacturer. Closing down an overseas factory disrupts a manufacturer's value chain. Closing down an overseas retail operation simply means losing one investment in a portfolio. The value chain of the retailer as a whole is not much affected. In other words, divesting oneself of a foreign direct investment is relatively much less disruptive to a retailer than to a manufacturer. Furthermore, a large proportion of the inventory of a food retailer includes fast moving consumer goods, which are usually bought on credit. Therefore, a retailer is less tied down in terms of cash flow, and their inventory can be sold faster in the case of closing down than that of a manufacturer. Consequently, exit is relatively easy in retail foreign direct investment. This point is very important because without the ease of exit, retailers would have probably been less proactive in seizing opportunities overseas than this study finds.

Beyond the finding that retailers are rather proactive in their internationalisation of operations, the evidence of this study also suggests that underlying their proactive behaviour, retailers pursue the objective of maximising long-term profits through exploiting and developing resources by maximising opportunities. This is instead of following a control led objective to minimise transactional market failure due to opportunism and bounded rationality as suggested in most of the existing international business literature. Provided that their financial situation permits, retailers proactively pursue foreign direct investment in order to exploit structural market failure to generate rent[3 & 4]. It appears that a retail firm chooses to undertake foreign direct investment rather than franchising or licensing[5] because their core competence is so firm specific[6] that when transferred to another firm, if transferable, the function and value of such expertise deteriorates. The deterioration is due to the absence of the support of the original firm's other resources, such as the original human resources and culture, that are conducive to the full functioning of the

[3] Transactional and structural market failure are discussed in Chapter 2.
[4] The rent earned by a firm is defined as the return in excess of the firm's opportunity cost.
[5] Export is out of consideration because of the non-tradable nature of retail services.
[6] A resource that is firm specific means that the function and hence value of such a resource deteriorates when it is transferred to another firm because the support of the original firm's other resources which are conducive to its functioning is lacking in the new firm (Tsang, 2000).

expertise. In other words, if the retail expertise or know-how is transferred to another firm, it will not generate the same maximum rent as if it would in the original firm. In this case, whether or not the retailer is able to form contracts that incorporate every possible detail to safeguard against opportunism is irrelevant to the decision. Therefore, the assumption of opportunism does not seem to be necessary in the case of retail FDI. At the same time, the role of bounded rationality in retail FDI seems to be different to that in manufacturing FDI. In the latter case, bounded rationality plays the role of limiting a firm's ability to form contracts to minimise opportunistic behaviour. In the case of retailing, it limits the rate at which a retail firm can expand. Obviously, a retailer's decision on whether to pursue a particular overseas expansion opportunity depends on the management's evaluation of the situation that surrounds the opportunity, based on its own activities and the activities of other actors in the environment. How they perceive the opportunity is then affected by bounded rationality. Moreover, if a retailer wants to expand, they need to increase management personnel. However, when a new member of staff joins the original team, it takes time for him to fit into the existing routine and culture of the management team. This, in turn, will also limit the rate of expansion of a retailer.

Elaborating on this idea, an international retail firm, as a whole, can be perceived as a collection of physical, human and organisational resources bounded together in an administrative framework. The capability of such firm is determined by its capacity to perform an activity as a result of organising and co-ordinating a group of relevant resources. If the retail firm possesses a certain capability that is better than that of its competitors, that capability becomes its competence or termed 'know-how' in this thesis. Retail know-how is highly firm specific due to the fact that it is derived from a specific combination of complementary resources embedded in the firm's extant context. Retail know-how is also largely tacit because it consists of a large amount of experiential insights that are difficult to articulate in precise terms. Therefore, transfer of retail know-how with the minimum loss of function and value may only be possible through real life interactions and exchanges between employees. This condition has two consequences. First, the scale of overseas expansion at any particular time depends on the number of capable managerial personnel in the existing organisation who can be relocated to the potential host countries to develop a capable team of managerial personnel. Secondly, as mentioned earlier, during the process of retail know-how transfer, core retail know-how is preserved while peripheral know-how is adjusted according to the local market condition. Deciding on what adjustments are adequate requires the accumulation and utilisation of knowledge of the local market. A high degree of autonomy given to the overseas operation is central to this whole process because it is the personnel who are actually experiencing the local market that possess the best knowledge of the market and how to react promptly.

Knowledge accumulation and utilisation does not only happen at the subsidiary level. The knowledge accumulated and learned in each overseas subsidiary forms an important source of innovation for the entire retail organisation, which in turn is crucial to the ability of the firm to carry on expanding overseas. Therefore, a retailer must possess the capability to preserve and coordinate the knowledge acquired by different overseas operations in order to facilitate the utilisation of knowledge in the organisation as a whole. The headquarters of food retailers are the strategic apex to assume this role. By so doing, new retail concepts can be generated and the retail firm can evolve and expand virtually endlessly, provided that the retail firm is financially healthy.

8.3 Business Implications: Prospective Retail Landscape in China

8.3.1 Continuity and Changes

The present research demonstrates that foreign retailers have experienced a certain degree of difficulty in their foreign direct investment undertakings in China over the last decade. Part of the difficulty stems from the lack of a systematic and reliable legal and regulatory framework; the strict control of the activities of foreign retailers; an under-developed road, transportation and telecommunication system; and a largely unskilled retail workforce, which are features of an economy in transition from a centrally planned economy towards a market economy. Another part of the difficulty is the lack of understanding of Chinese business and social culture.

The features of a transitional economy will gradually disappear in China as the country's development progresses. For example, as part of the process of strengthening the rule of law in China, a large amount of legislation covering areas such as land ownership, contract and securities has been prepared. The process will continue as the economic transformation carries on. Consequently, the uncertainty and confusion that surrounds the legal status of economic entities and transactions will slowly recede. As a further example, the complicated legislation concerning site acquisition and store development that foreign retailers face in China should become increasingly simplified and systematic. As a whole, the accelerated development of a more transparent and systematic legal system is expected. On the other hand, China's transportation system, although it has failed to keep pace with the country's economic development, is being continuously improved. The system should see significant advancement as China's economic reform proceeds. Consequently, the difficulty caused by the ephemeral features of a transitional economy will disappear as the transition process advances.

By contrast, trust and *guanxi* will always remain an important element in doing business in a Chinese community. Some scholars argue that informal relationships and the development of trust are only important in China at the moment when its institutional environment, in particular the legal and regulatory system, is uncertain and dynamic (Chen and Boggs, 1998; Alston, 1989 in Park and Luo, 2001). The importance of relationships and trust development with governmental authorities will undeniably diminish as government intervention in the market decreases. However, reliance on trust and *guanxi* in business dealings between channel members in China is believed to remain important. This is because heavy reliance on trust and relationships is witnessed in the business communities of the overseas Chinese Diaspora, even when the community operates in a well-developed and reliable legal system such as the US, the UK and Singapore. Hong Kong also used to be one example of such overseas Chinese communities. It has a well-developed legal system that follows the system of the United Kingdom but displays heavy reliance on trust and *guanxi* within business dealings. Furthermore, the advantages of having trust between channel members have been well-documented. Therefore, foreign retailers should spend time and effort in understanding Chinese culture and in cultivating trust and long-term oriented *guanxi* with their channel members.

8.3.2 Economic Outlook and Institutional Changes

Taking a long-term, holistic perspective, the author has confidence that the economy in China will take off. The process of transformation is gaining further momentum after the country's entry into the WTO in December 2001, which will incontrovertibly produce greater integration between China and the rest of the world. As discussed in the thesis, this event has brought about China's promise to abolish restrictions on foreign trade and foreign direct investment within three to five years.

Simultaneously, the intention and determination of the Chinese government to accelerate the process of transition is also reflected in the Tenth Five-Year Plan (2001-2005)[7], which was published in March 2001 and approved at the annual meeting of the National People's Congress. According to the plan, China will endeavour to maintain a GDP growth rate of 7% a year, taking GDP in 2005 to Rmb12.5 trillion (US$1.5 trillion) in 2000 prices and GDP per capita to Rmb 9 400 (US$ 1 135). In terms of economic reform, the country aims to transform the "socialist market economic system" to "complete the establishment of a modern enterprise system with clearly established ownership, well defined power and responsibility, and separation of enterprise management from government administration", albeit "public ownership plays a dominant role". Simultaneously, government organisations will be continuously reformed and streamlined.

In fact, the Economist Intelligence Unit[8] speculates that gradual but steady economic liberalisation will continue in China and predicts that real GDP will grow by 7.3% in 2002 and accelerate to 7.6% in 2003. The Development Bank of Singapore[9] estimates that FDI inflow in China will increase to US$ 50 billion in 2003. Per capita

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[7] See Appendix 8.1

[8] Economist Intelligence Unit. 2002. "Forecast" *Economist Intelligence Unit*. 22 February. [Online] Available from: URL: http://www.economist.com/countries/China/profile.cfm?folder=Profile-Forecast [Accessed 22 February 2002].

income is also believed to rise in 2002 and hence continuously increase urban affluence. Moreover, the growth in per capita income is expected to lead to an increase of 8.7% in private consumption in the same year[10].

Based on the above factors, the author believes that the economic development in China will reach new heights in the near future. This, together with the promising advancement in the supporting infrastructure, should increase China's attractiveness to foreign direct investment in retailing.

8.3.3 Forecast on Foreign Food Retailing in China

According to the present study, foreign retailers who adopted the formats of hypermarket, supercentre, superstore and cash and carry have been continuously expanding in terms of number of outlets in China. Up to 2000, there were 29 state-approved retail joint ventures, with most of them originating from Asia and a few from Europe and North America (Euromonitor, 2000a). Among them, Wal-Mart has successfully opened seven supercentres and one 'Sam's Club', with a total investment close to RMB 905 million. Carrefour has opened 23 chain stores in 15 Chinese cities. Metro has also opened seven outlets. Furthermore, Metro has successfully signed an official investment agreement to set up the Metro Warehouse Management Company, which is the first wholly foreign-owned wholesaler in Western China. Further expansion of these retailers in terms of number of outlets and into different cities is expected.

In the past, foreign retailers were unable to exploit their expansion into other cities to achieve a surge in bargaining power because it was difficult to centralise buying activities across provinces due to regional protection. Local governments tended to close their markets to companies from other Chinese cities and provinces. The tactics employed included the use of issuance of border cards, which companies needed if they wanted to bring their goods in from other cities; discriminatory fees imposed on

[9] Development Bank of Singapore. 2001. *A First Look at China in 2002*. 21 September. [Online] Available from: URL: http://www.tdb.gov.sg/china/marketresearch/reports/mf2001sep20cn.pdf [Accessed 13 February 2002].

[10] Institute of Developing Economies. 2002. [Online] Available from: URL: http://www.ide.go.jp/English/New/Press/pdf/2002_china.pdf [Accessed 13 February 2002].

goods from other cities; and the application of special technical requirements or inspection standards on products from other cities and regions. In such a situation, the mobility of goods was hindered. Consequently, integrating buying activities of outlets in different provinces was difficult. However, this situation should be changed by the implementation of the *Measures to Ban Regional Economic Blockades* promulgated in April 2001. This measure prohibits local governments from using methods such as those described above to achieve regional protection. This prohibition will help foreign retailers to integrate their buying activities in different provinces, which will in turn increase their bargaining power over suppliers. An increase in scale of supply chain activities co-ordination between different retail outlets of a retailer in different provinces will also be further assisted as the number of foreign companies entering the wholesaling and the transportation sectors in China increases. This is because these foreign companies will offer services of a higher standard than local ones, and will catalyse the modernisation of the distribution industry at a faster pace. Following this prediction, foreign retailers should be able to establish a national supply chain network in China in the near future, which will benefit both local manufacturers and foreign retailers. With a national supply chain network, foreign retailers, as mentioned earlier, could derive more bargaining power. Simultaneously, local manufacturers could extend the reach of their products to other provinces, leading inevitably to increased concentration of production.

The expansion of foreign retailers in China, however, is likely to be constrained by the deficiency of competent human resources. There is no question that foreign retailers rigorously train their Chinese staff to take up managerial positions in China. Nevertheless, food retailing is a highly labour-intensive industry. The rapid opening of stores in different provinces of China will require a large number of competent personnel for managerial positions. How can the number of people being trained by foreign food retailers catch up with the number they require for their cross-province expansion is an important issue that foreign retailers should consider seriously. Furthermore, such expansion of foreign food retailers and their formation of a national supply network will also require a compatible logistic and transportation industry in China. Nonetheless, the logistic and transportation sector in China is still not well-developed. In other words, this is another problem that foreign retailers will need to confront. As mentioned earlier, some foreign companies have entered the logistic and transportation sector in China. Undeniably, this would help the modernisation of the sector and may consequently alleviate the problem. However, as foreign retailers expand, their demand on logistic and transportation services will increase. In other words, there will be pressure to expand on these foreign logistic and transportation firms. When these foreign logistic and transportation firms expand, they will face the same problem regarding the availability of competent human resources in China, as will the other supporting industries.

On the other hand, supply chain networks of retailers beyond the national level may be developed as China further opens up and extends its export trade. Foreign retailers in China, with their global presence, provide an excellent means through which Chinese products can enter the global procurement system. In fact, as pointed out in the thesis, some foreign retailers were enthusiastic to find and develop producers in China from whom they can source quality merchandise for operations in other countries. In Asia, China and many other countries are members of the Asian Pacific Economic Cooperation (APEC) forum, whose primary goal is to promote open trade and practical economic cooperation in the region. Connected by APEC, the import and export activities among the member countries should become easier. Based on these factors, there is a high possibility that foreign retailers in China will increase the scale of their supply chain network to cover Asia in due course. In other words, China may become an important base for supply chain activities of retailers in Asia. In such a scenario, the power of international retailers will be further consolidated.

Foreign food retailers in China are indisputably instrumental in the modernisation of the retail and distribution industry in the country because they have introduced 'new' marketing methods, technology and management in both the retail and distribution sectors. Furthermore, their power, following the previous discussion, is likely to be further strengthened. However, does it mean that foreign retailers in China will dominate the country as they develop further? The author would suggest that this is not necessarily the case because of the following factors.

First, despite the success of a number of foreign food retailers, some retailers have withdrawn their investment in China. Royal Ahold, a leading retailer from Holland, entered China with the supermarket format. It opened quite a large number of outlets in Shanghai. In mid-1999, the company was attempting to consolidate the chain. However, towards the year-end of 1999, it decided to withdraw from China. Dairy Farm Group from Hong Kong has also closed all its supermarket outlets in China, mainly in the southern part, about two years ago and decided to concentrate on their convenience store businesses in China. The present study has not researched the reasons of exit for these companies. Nevertheless, on a superficial level, entering China with the supermarket format does not appear to be an appropriate strategy. For foreign retailers at the time being, food retailing in larger scale seems to be more appealing in China[11]. One plausible explanation for the take-off of the concept of one-stop shopping is, as pointed out in the thesis, that stores with such a concept offer a familiar department store setting with less elaborate decoration and products sold at much lower prices. Such combination of ambience and price creates the more casual shopping experience that many Chinese consumers desired. Although the actual reasons for the take-off of hypermarkets, superstores and cash and carrys, and the real cause of disposal of Ahold's and Dairy Farm's businesses in China are unknown, the two examples do show that foreign retailers with the latest retail information technology and retail know-how do not necessarily prosper in China.

Secondly, some indigenous retailers in China have the potential to develop into significant rivals to the foreign retailers. Shanghai is the city in China where retailing has been most developed. There are two big local supermarket chains in the city: Lianhua and Hualian. Each of them has over 300 supermarket outlets. Their respective sales value ranks among the top businesses in the whole of China. As pointed out in the thesis, the Chinese government was keen to restructure and consolidate the indigenous retailers in Shanghai and Beijing in order to improve and strengthen the power of Chinese retailers.

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[11] This point is discussed further in section 8.4.

Some people may argue that the local retailers do not possess the management and marketing skills that are crucial to the success of a retail business. This may be true for the time being. However, as the retail and distribution industry develops, local retailers will gradually catch up with these skills. This, if combined with the continuous strong support of the Chinese government, will ensure that some Chinese retailers will have the potential to become strong competitors to foreign retailers in the future. In fact, the present study shows that the development of the retail and distribution industry in China as a whole has been quite remarkably rapid. The advance of Chinese retailers may also take place at an amazing pace. Actually, indigenous hypermarkets were already emerging when the author undertook fieldwork. In one of these hypermarkets, there were posters all around the store with the slogan "中国人自己的大卖场", meaning "Chinese People's Own *Damaichang*". The seeds of enthusiasm of local retailers for catching up and competing with foreign retailers appear to be well planted.

Third, the instant success of foreign retailers in China may not imply that the retail concepts from their home countries are suitable for China in the long run. Retailers should note that demographic factors and consumer behaviour in terms of food shopping in China are not identical to those in many Western countries. For example, household floor space in China is very limited and Chinese consumers have a strong preference for fresh food. When these two conditions are combined together, Chinese consumers shop more frequently but have a smaller basket value than Europeans or Americans on each shopping trip. Moreover, the author observed that many customers of hypermarkets walked to the store. The author also observed that one Carrefour outlet in Beijing did not even offer a proper parking area around the store. These situations are different to those in Europe. Even with further economic reform, the situation will probably remain unchanged in China for deep-rooted social and economic reasons. The author remains sceptical about the sustainability of the success of all current foreign retail formats in China. In fact, the present study has shown that some retailers recognised the need to invest in developing a more optimal format for China and have started modifying their formats. There is a high probability that the existing foreign retail formats will evolve to something different as they develop in China.

When the above three factors are combined together, the author would suggest that some Chinese retailers should be able to catch up with foreign retailers in terms of size, retail information technology and management skills in the foreseeable future. At the same time, it seems doubtful that the 'uniqueness' of the demographic characteristics and consumer behaviour in China are fully reflected in retail concepts in the country. This process of adaptation essentially requires an in-depth understanding of the Chinese grocery-shopping culture and a high sensitivity to consumers' need. Therefore, taking a long-term perspective, the fundamental factor that will determine the future competitive landscape of Chinese and foreign food retailers is not who possesses the latest retail technology and know-how, but who possesses the most relevant retail know-how in the context of China. Consequently, the author would argue that foreign retailers may not necessarily dominate the Chinese food retail market in the long run.

8.4 Suggestions for Further Research

Apart from contributing to a better understanding of the process of foreign direct investment in food retailing in China, the present study has also revealed several issues that need further research. First, as mentioned earlier, some foreign food retailers have exited China not long after their entry. The reasons that led to their exit should be investigated to provide further insights into the relationship between retail format and success in food retailing in China.

Secondly, the present study looks at the process of foreign direct investment in food retailing in China mainly from the viewpoint of foreign retailers. The perceptions and reactions of Chinese consumers has not been examined. Future research effort should be invested in this topic because this will offer a significant understanding of adaptations that foreign retailers need to make in the future. Such research will also shed some light on the retail concept/format that is most suited to Chinese consumers' needs.

The third issue to which future research effort should be directed is the development of supply chain relationships in China. Efficient Consumer Response (ECR) is a popular system in Europe and the US. Some foreign retailers in the present study were looking forward to implementing a similar system in China in cooperation with multinational manufacturers such as Proctor and Gamble. However, there has to be a sufficiently high level of retailer and producer concentration before such system is viable. The question is whether or not such consolidation will occur in the foreseeable future in China. Another significant issue is whether foreign retailers will prefer to develop and collaborate with local retailers or whether they will stick with multinational manufacturers. The author's empirical work suggests that several foreign retailers were keen to develop local manufacturers and were considering joint product development with them. The question then arises as to whether foreign retailers are deliberately attempting to reduce their reliance on multinational manufacturers. On the other hand, if local manufacturers achieve a high standard of supply, they may not be able to stay in the market for long because multinational manufactures may acquire these firms. All these issues are worth exploring because this will not only facilitate understanding of the development of relationships between manufactures and retailers in China but will also deepen understanding of the price setting power of retailers and manufacturers as both groups seek to consolidate their positions in China and more widely.

Lastly, the current investigation has revealed that a learning-oriented culture and knowledge accumulation and utilisation are crucial in the process of foreign direct investment of food retailers at both the subsidiary level and across the whole organisation. This issue should be examined further at headquarters level in order to obtain a deeper understanding of how knowledge learnt at the subsidiary level can be disseminated and exchanged across the entire retail organisation in order to sustain retail innovation and enhance competitiveness at an international level.

As a final remark, the author hopes that this exploratory study of one of the major retail markets will stimulate further research efforts and lead to a more solid understanding of the process of retail internationalisation.

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Appendix 1.1

Gross Domestic Production (GDP) Statistics of China Between 1978 and 2001

Year	GDP (billion RMB)	GDP (billion US$)	GDP Index (previous year=100)
1978	362.41	43.66	111.7
1979	403.82	48.65	107.6
1980	451.78	54.43	107.8
1981	486.24	58.58	105.2
1982	529.47	63.79	109.1
1983	593.45	64.99	110.9
1984	717.10	86.40	115.2
1985	896.44	108.00	113.5
1986	1020.22	122.92	108.8
1987	1196.25	144.13	111.6
1988	1492.83	179.86	111.3
1989	1690.92	203.73	104.1
1990	1854.79	233.47	103.8
1991	2161.78	260.46	109.2
1992	2663.81	320.94	114.2
1993	3463.44	417.28	113.5
1994	4675.94	563.37	112.6
1995	5847.81	704.56	110.5
1996	6788.46	817.89	109.6
1997	7446.26	897.14	108.8
1998	7834.52	943.92	107.8
1999	8191.09	986.88	107.1
2000	8963.59	1079.95	108.0
2001	Approx. 9500	1144.58	107.4

Sources:

GDP in RMB and GDP Index between 1978 and 1999 are obtained from:
China National Bureau of Statistics. 2000b. *China Statistic Yearbook 2000.* [Online] Available from: URL: http://www.stats.gov.cn/sjjw/ndsj/zgnj/2000/C01c.htm [Accessed 16 February 2002].

GDP in US$ in 2000 is obtained from:
World Bank. 2001a. *World Development Indicators database.* 16 July. [Online] Available from: URL: http://www.worldbank.org/data/databytopic/GDP.pdf [Accessed 16 February 2002].

GDP Index 2000 is obtained from:
China National Bureau of Statistics. 2002. "Statistics on China's Economy in Recent Five Years". *People's Daily Online.* 3 January. [Online] Available from: URL: http://english.peopledaily.com.cn/200201/03/eng20020103_87987.shtml [Accessed 16 February 2002].

GDP in RMB and GDP Index in 2001 are obtained from:
People's Daily Online. 2001. "China's Economy to Grow 7.4 Percent, GDP to Top US$1.15 Trillion This Year." *People's Daily Online.* 21 December. [Online] Available from: URL:

http://english.peopledaily.com.cn/200112/21/eng20011221_87212.shtml [Accessed 16 February 2002].

GDP 1978-1999 and 2001 are converted from RBM to US$ and GDP 2000 from US$ to RMB using the exchange rate of RMB 8.3=US$ 1.

Appendix 2.1

Bain-Type Advantages

The following is a table taken out from Hymer (1976:44-45) that summarises J. S. Bain's description of advantages of established firms and the circumstances in which they arise. These advantages are termed Bain-type advantages, which are seen as structural imperfections, by scholars such as Dunning and Rugman (1985).

I. Typical circumstances giving rise to an absolute cost advantage to established firms A. Control of production techniques by established firms, via either patents or secrecy. (Such control may permit exclusion of entrants form access to optimal techniques, or alternatively the levying of a discriminatory royalty charge for their use.) B. Imperfections in the markets for hired factors of production (e.g. labour, materials, etc.) which allow lower buying prices to established firms; alternatively ownership or control of strategic factors supplies (e.g. resources) by established firms, which permits either exclusion of entrants from such supplies, driving entrants to use inferior suppliers, or discriminatory pricing of suppliers to them. C. Significant limitations of the suppliers of productive factors in specific markets or submarkets for them, relative to the demands of an efficient entrant firm. Then an increment to entry will perceptibly increase factor prices. D. Money-market conditions imposing higher interest rates upon potential entrants than upon established firms. (These conditions are apparently more likely to be effective as a source of advantage to established firms as the absolute capital requirement for an efficient entrant increases.)
II. Typical circumstances giving rise to a product differentiation advantage to established firms A. The accumulative preference of buyers for established brand names and company reputations, either generally or except for small minorities of buyers. B. Control of superior product designs by established firms through patents, permitting either exclusion of entrants from them or the levying of discriminatory royalty charges. C. Ownership or contractual control by established firms of favoured distributive outlets, in situations where the supply of further outlets is other than perfectly elastic.
III. Typical circumstances discouraging entry by sustaining significant economies of the large-scale firm A. Real economies (i.e. in terms of quantities of factors used per unit of output) of large-scale production and distribution such that an optimal firm will supply a significant share of the market. B. Strictly pecuniary economies (i.e. monetary economies only, such as those due to the greater bargaining power of large buyers) of large-scale production, having a similar effect. C. Real or strictly pecuniary economies of large-scale advertising or other sales promotion, having a similar effect.

Appendix 4.1

Case Study Memorandum

This case study memorandum served as the blueprint for the author to collect information from various sources for the study. The questions set out here were also used as semi-structured, open-ended questions for the interviews. The reader should note that this memorandum was not distributed to any informants to be filled in. Questions were asked by the author and the respondents were expected and encouraged to elaborate. On the other hand, when the respondents felt that certain questions were too sensitive and refused to discuss, they were welcome to do so.

Topics of Inquiry

1. Retailing environment

How does your company evaluate the retailing environment of Shenzhen, Guangdong, Shanghai and Beijing in terms of competitions, consumers, governement support and availability of market information?

Why did your company choose only to operate in Shenzhen and Guangdong at the moment?

2. Supply Chain Management

How many layers are there in the channel for fresh food, chilled food, frozen food, canned food, or others (in other words, do you deal with middlemen or with manufacturers)? Why do you choose this channel structure? What is your future direction in this aspect?

Who are your suppliers and how do you choose your suppliers?

What is the proportion of merchandise supplied by local Chinese suppliers, regional Chinese suppliers, international suppliers (such as P&G) and are imported? Why these proportion? How dynamic are these proportions?

What is the proportion of sales accounted for by local Chinese suppliers, regional Chinese suppliers, international suppliers, import products? How dynamic are these proportions?

What are the credit systems with local, regional and international suppliers respectively? Are they different significantly? How are the credit terms determined?

What are your relationships with the local, regional and international suppliers? How do these relationships, if any, affect the development of your retail presence in China? Do you have any collaborating activities (such as product development)? Do you share market information? If yes, what kind?

How are the buying activities organised in your company (stored based or centralised) (any differences for different products)? (such as, who are responsible for the buying for the different stores?)

How is the co-ordination of supply chain activities for all the stores in China (especially inter-provincial coordination)?
What do you think about the quality of products supplied by local and regional suppliers, especially fresh food, in China when compared with the situation in say America? And how do you control the quality?

Logistic issues:
What kind of transportation fleets do you use?
What is the number of distribution depots and floor area?
What kind of warehousing do you use? How about in-store warehouses and their floor space?
How do you co-ordinate the logistic activities?
What are the problems with logistic activities in China?
What is the extent to which technology is involved in logistic activities?
How is the situation of delay in delivery from suppliers?
How do you overcome it?

How you do you think the distribution system in China will change in the near future?

3. Retailing Operation

What is the number of product lines you carry? What is the average floor space? How much is devoted to fresh food?

What is the proportion of sales accounted for by fresh food? (if it is too sensitive, is it possible for you to give me a rough idea?)

What is the product you emphasis most in your retail stores?

How do you describe your retail concept? In other words, what do you think your competitive advantage is in Shenzhen and Guangdong? On what do you compete? How do you describe your retail store format and atmosphere?

What adjustments are made to the parent company's strategy to suit the local situation?
What changes have been introduced into the product range compared with domestic operations? (such as range of assortment, package size, price, packaging)

What is the approximate shrinkage rate (staff and customer stealing plus wastage)? Do you think they are a serious problem to your stores? How do you overcome it?

How often do you conduct consumer research in your stores or outside your stores? How is it conducted? Who does market research for your company? What are the difficulties in doing market research in China?

How do you evaluate the performance and market position of your retail operations in China at the moment when compared to your original expectation? What do you expect in it to be in the future?

Other factual information:
Volume of stock?
Sales turnover p.a?
Average amount per shopping trip of customers?
Average margin?
How frequent do the customers visit the store?
What point of sales data is collected and what is done with it?
What is the usual method of payment by Customers?
(for all of the above questions, if you cannot provide me with the exact answer, could you please suggest me a rough idea?)

4. Store Development and Site-Selection/Acquisition

What is the number of stores opened per year since your first entry into China? Any closure? If yes, why? What are their format and what are the store sizes(m^2)? What will be the rate of increase in number of stores in the near future and where?

Are the sites of current stores owned or rented? Were they greenfield or brownfield sites? What is the preference of your company and why? How many and what kinds of licenses are needed for different products and for each site? From whom? How important are local lawyers to get these licenses?

How does the company become aware of a possible site? (role of auction/partnership with other company/private overture)
How does the company evaluate sites?
What is the availability of (I) advisors and (II) contractors for the development of store?
Is there any expertise introduced from the parent in terms of site selection and store development?

What is the trends in site availability in terms of numbers of sites available and cost/price trends?
Are your stores one off locations or part of centre development?
Any political opposition from small local retailers?

5. Legal and regulatory catalysts/barriers to establish retail presence in China

What are the legal and regulatory procedures for establishing a store in China (or in Beijing, Shenzhen/Guangdong, or Shanghai)?

What is the role, if any, of the Chinese government (at different levels) in your FDI venture?

What are the main legal and regulatory catalysts (or any help from the government at different levels: municipal, provincial and central) and barriers (at different levels)? How do you overcome the barriers?

What kind of relationship do you have with the Chinese government at different levels? (such as do you have any joint activities with the governemnt? What are they?)

6. Input from Chinese Partners

Which kind of joint venture is your retail operation in China, equity, wholly-owned or cooperative venture?

Who is/are your partner(s)? Why did you choose this/these partners? What is the contribution to the venture from each partner?

What is the sharing of power among different partners (Legal equity and ownership vs. managerial control/amount of influence through broad members and specific managers)?
Is there any advantage or problem arise as a result of this partnership structure?

7. Human Resources Management

What is the proportional of expatriates vs. local staff? Why this proportion? What is the future trend in this proportion?

What qualifications are required on your local employees? What is the training package offered to local management team and local staff? How do you describe the availability of quality candidates in China? Are there any problems with using local employees? Any advantages?

How experienced are the expatriates on running retail operation away from the home country? How long do they usually stay in China? Do they receive any training before they leave the home country? If yes, what kind of training is it?

How important does the company think human resources is?

Personally, how will you describe your experience on retailing in China when compared with your experience on retailing in your home country? What have you learnt which is unique in retailing in China? How do you share your experiences within the company?

8. What kind of support do you get from your parent retail company in the home country or from your retail operations in other countries for your retail operation in China? How much autonomy is delegated to your operation in China?

9. What is the history of internationalisation of your company? How does it affect the establishment of a retail presence in China? Why does your company internationalise? Why is China chosen? Were other countries instead of China considered? If yes, which?

Note: Apart from the questions above, ask the retailers for an address list of all their stores in China and any other published information on their China operations they have.

Appendix 6.1

Law of the People's Republic of China on Foreign Capital Enterprises

(Adopted at the Fourth Session of the Sixth National People's Congress on April 12, 1986, promulgated by Order No. 39 of the President of the People's Republic of China and effective as of April 12, 1986)

Article 1 With a view to expanding economic co-operation and technical exchange with foreign countries and promoting the development of China's national economy, the People's Republic of China permits foreign enterprises, other foreign economic organisations and individuals (hereinafter collectively referred to as "foreign investors") to set up enterprises with foreign capital in China and protects the lawful rights and interests of such enterprises.

Article 2 As mentioned in this Law "enterprises with foreign capital" refers to those enterprises established in China by foreign investors, exclusively with their own capital, in accordance with relevant Chinese laws. The term does not include branches set up in China by foreign enterprises and other foreign economic organisations.

Article 3 Enterprises with foreign capital shall be established in such a manner as to help the development of China's national economy; they shall use advanced technology and equipment or market all or most of their products outside China.

Provisions shall be made by the State Council regarding the lines of business which the State forbids enterprises with foreign capital to engage in or on which it places certain restrictions.

Article 4 The investments of a foreign investor in China, the profits it earns and its other lawful rights and interests are protected by Chinese law.

Enterprises with foreign capital must abide by Chinese laws and regulations and must not engage in any activities detrimental to China's public interest.

Article 5 The State shall not nationalise or requisition any enterprise with foreign capital. Under special circumstances, when public interest requires, enterprises with foreign capital may be requisitioned by legal procedures and appropriate compensation shall be made.

Article 6 The application to establish an enterprise with foreign capital shall be submitted for examination and approval to the department under the State Council which is in charge of foreign economic relations and trade, to another agency authorised by the State Council. The authorities in charge of examination and approval shall, within 90 days from the date they receive such application, decide whether or not to grant approval.

Article 7 After an application for the establishment of an enterprise with foreign capital has been approved, the foreign investor shall, within 30 days from the date of receiving a certificate of approval, apply to the industry and commerce administration authorities for registration and obtain a business licence. The date of issue of the business licence shall be the date of the establishment of the enterprise.

Article 8 An enterprise with foreign capital which meets the conditions for being considered a legal person under Chinese law shall acquire the status of a Chinese legal person, in accordance with the law.

Article 9 An enterprise with foreign capital shall make investments in China within the period approved by the authorities in charge of examination and approval. If it fails to do so, the industry and commerce administration authorities may cancel its business licence. The industry and commerce administration authorities shall inspect and supervise the investment situation of an enterprise with foreign capital.

Article 10 In the event of separation, merger or other major changes, an enterprise with foreign capital shall report to and seek approval from the authorities in charge of examination and approval, and register the change with industry and commerce administration authorities.

Article 11 The production and operating plans of enterprises with foreign capital shall be reported to the competent authorities for the record.

Enterprises with foreign capital shall conduct their operations and management in accordance with the approved articles of association, and shall be free from any interference.

Article 12 When employing Chinese workers and staff, an enterprise with foreign capital shall conclude contracts with them according to law, in which matters concerning employment, dismissal, remuneration, welfare benefits, labour protection and labour insurance shall be clearly prescribed.

Article 13 Workers and staff of enterprises with foreign capital may organise trade unions in accordance with the law, in order to conduct trade union activities and protect their lawful rights and interests.

The enterprises shall provide the necessary conditions for the activities of the trade unions in their respective enterprises.

Article 14 An enterprise with foreign capital must set up account books in China, conduct independent accounting, submit the fiscal reports and statements as required and accept supervision by the financial and tax authorities.

If an enterprise with foreign capital refuses to maintain account books in China, the financial and tax authorities may impose a fine on it, and the industry and commerce administration authorities may order it to suspend operations or may revoke its business licence.

Article 15 Within the scope of the operations approved, enterprises with foreign capital may purchase, either in China or from the world market, raw and semi-processed materials, fuels and other materials they need. When these materials are available from both sources on similar terms, first priority should be given to purchases in China.

Article 16 Enterprises with foreign capital shall apply to insurance companies in China for such kinds of insurance coverage as are needed.

Article 17 Enterprises with foreign capital shall pay taxes in accordance with relevant state provisions for tax payment, and may enjoy preferential treatment for reduction or exemption from taxes.

An enterprise that reinvests its profits in China after paying the income tax ,may, in accordance with relevant state provisions, apply for refund of a part of the income tax already paid on the reinvested amount.

Article 18 Enterprises with foreign capital shall handle their foreign exchange transactions in accordance with the state provisions for foreign exchange control.

Enterprises with foreign capital shall open an account with the Bank of China or with a bank designated by the state agency exercising foreign exchange control.

Enterprises with foreign capital shall manage to balance their own foreign exchange receipts and payments. If, with the approval of the competent authorities, the enterprises market their products in China and consequently experience an imbalance in foreign exchange, the said authorities shall help them correct the imbalance.

Article 19 The foreign investor may remit abroad profits that are lawfully earned from an enterprise with foreign capital, as well as other lawful earnings and any funds remaining after the enterprise is liquidated.
Wages, salaries and other legitimate income earned by foreign employees in an enterprise with foreign capital may be remitted abroad after the payment of individual income tax in accordance with the law.

Article 20 With respect to the period of operations of an enterprise with foreign capital, the foreign investor shall report to and secure approval from the authorities in charge of examination and approval. For an extension of the period of operations, an application shall be submitted to the said authorities 180 days before the expiration of the period. The authorities in charge of examination and approval shall, within 30 days from the date such application is received, decide whether or not to grant the extension.

Article 21 When terminating its operations, an enterprise with foreign capital shall promptly issue a public notice and proceed with liquidation in accordance with legal procedure.
Pending the completion of liquidation, a foreign investor may not dispose of the assets of the enterprise except for the purpose of liquidation.

Article 22 At the termination of operations, the enterprise with foreign capital shall nullify its registration with the industry and commerce administration authorities and hand in its business licence for cancellation.

Article 23 The department under the State Council which is in charge of foreign economic relations and trade shall, in accordance with this Law, formulate rules for its implementation, which shall go into effect after being submitted to and approved by the State Council.

Article 24 This Law shall go into effect as of the date of its promulgation.

Appendix 6.2

Rules for the Implementation of the Law of the People's Republic of China on Foreign-Capital Enterprises

(Approved by the State Council on October 28, 1990, and promulgated by Decree No. 1 of the Ministry of Foreign Economic Relations and Trade on December 12, 1990)

Contents

Chapter I

General Provisions

Article 1 These Rules are formulated in accordance with the provisions in Article 23 of The Law of the People's Republic of China on Foreign-Capital Enterprises.

Article 2 Foreign-capital enterprises shall be under the jurisdiction of and protection by China's laws.

Foreign-capital enterprises, while engaged in business operational activities within the territory of China, must abide by Chinese laws and regulations and must not jeopardise the social and public interests of China.

Article 3 A foreign-capital enterprise to be established in China must be conducive to the development of China's national economy, be capable of gaining remarkable economic results and shall meet at least one of the following conditions:

(1) The enterprise is to adopt advanced technology and equipment, engage in the development of new products, conserve energy and raw materials, and realise the upgrading of products and the replacement of old products with new ones which can be used as import substitutes;

(2) Its annual output value of export products accounts for more than 50% of the annual output value of all products, thereby realising the balance between revenues and expenditures in foreign exchange or with a surplus.

Article 4 No foreign-capital enterprise shall be established in the following trades:

(1) The press, publication, broadcasting, television and movies;

(2) Domestic commerce, foreign trade, and insurance;

(3) Post and telecommunications;

(4) Other trades in which the establishment of foreign-capital enterprises is forbidden, as prescribed by the Chinese government.

Article 5 The establishment of foreign-capital enterprises shall be restricted in the following trades:

(1) Public utilities;

(2) Communications and transportation;

(3) Real estate;

(4) Trust investment;

(5) Leasing

The application for the establishment of a foreign-capital enterprise in the trades mentioned in the preceding paragraph shall be submitted to the Ministry of Foreign Economic Relations and Trade of the People's Republic of China (hereinafter referred to as the Ministry of Foreign Economic Relations and Trade) for approval, except as otherwise provided by Chinese laws and regulations.

Article 6 Application for the establishment of a foreign-capital enterprise shall not be approved if the proposed enterprise would involve one of the following circumstances:

(1) Injury to China's sovereignty or to social and public interests;

(2) Impairment of China's national security;

(3) Violation of Chinese laws and regulations;

(4) Incompatibility with the requirements of China's national economic development; or

(5) Possible creation of environmental pollution.

Article 7 A foreign-capital enterprise shall make its own managerial decisions within the approved scope of business operations and shall not be subject to intervention.

Chapter II

Procedures for Establishment

Article 8 The application for the establishment of a foreign-capital enterprise shall be submitted to the Ministry of Foreign Economic Relations and Trade, and after examination and approval, a certificate of approval shall be issued by the Ministry.

With respect to the application for the establishment of a foreign-capital enterprise that comes under one of the following circumstances, the State Council shall authorise the people's government of the relevant province, autonomous region, municipality directly under the Central Government, municipality separately listed on the state plan, or the special economic zone, to issue the certificate of approval after examining and approving the application:

(1) The total amount of investment is within the limits of powers for the examination and approval of investments stipulated by the State Council;

(2) The proposed enterprises does not need the raw and processed materials to be allocated by the State, or does not influence unfavourably the national comprehensive balance of energy resources, communications and transportation, as well as export quotas for foreign trade.

Where the people's government of the province, autonomous region, municipality directly under the Central Government, municipality separately listed on the state plan, or the special economic zone has approved the establishment of a foreign-capital enterprise within its limits of powers granted by the State Council, it shall within 15 days after the approval submit a report to the Ministry of Foreign Economic Relations and Trade for the record (hereinafter the Ministry of Foreign Economic Relations and Trade, the people's government of the province, autonomous region, municipality directly under the Central government, municipality separately listed on the State plan, and the special economic zone shall be called generally as the examining and approving organ).

Article 9 With respect to a foreign-capital enterprise, the establishment of which has been applied for, if its products are subject to export license, export quota, or import license, or are under restrictions by the State, prior consent of the department of foreign economic relations and trade shall be obtained in accordance with the limits of powers for administration.

Article 10 A foreign investor shall, prior to the filing of an application for the establishment of a foreign-capital enterprise, submit a report to the local people's government at or above the county level at the place where the proposed enterprise is to be established. The report shall include: the aim of the establishment of the proposed enterprise; the scope and scale of business operation; the products to be produced; the technology and equipment to be adopted and used; the proportion of the sales of products between the domestic market and the foreign market; the area of land to be used and the related requirements; the conditions and quantities of water, electricity, coal, coal gas and other forms of energy resources required; and the requirement of public facilities.

The local people's government at or above the county level shall within 30 days after receiving the report submitted by the foreign investor, give a reply in writing to the said foreign investor.

Article 11 In case that a foreign investor wishes to establish a foreign-capital enterprise, an application shall be submitted to the examining and approving organ through the local people's government at or above the county level at the place where the enterprise is to be established, together with the following documents.

(1) The written application for the establishment of a foreign-capital enterprise;

(2) A feasibility study report;

(3) The articles of association of the foreign-capital enterprise;

(4) The name-list of the legal representatives (or the candidates for members of the board of directors) of the foreign-capital enterprise;

(5) The legal certifying documents and the credit position certifying documents of the foreign investor;

(6) The written reply given by the people's government at or above the county level at the place, where the enterprise is to be established;

(7) An inventory of goods and materials needed to be imported;

(8) Other documents that are required to be submitted.

The documents mentioned in items (1) and (3) in the preceding paragraph must be written in the Chinese language; while the documents mentioned in Items (2), (4) and (5) in the preceding paragraph may be written in a foreign language, but a corresponding Chinese translation shall be attached.

In the event that two or more foreign investors jointly file an application for the establishment of a foreign capital enterprise, they shall submit a duplicate of the contract concluded and signed between them to the examining and approving organ for the record.

Article 12 The examining and approving organ shall, within 90 days after receiving all the required documents with respect to an application for the establishment of foreign-capital enterprise, make a decision whether to approve or disapprove the application. In the event that the examining and approving organ has found that the documents mentioned above are not complete, or that some of them are inappropriate, it may call on the applicant to make up the incomplete documents, or to make necessary revisions, within a prescribed time limit.

Article 13 After the approval of the application for the establishment of a foreign-capital enterprise by the examining and approving organ, the foreign investor shall, within 30 days after receiving the certificate of approval, file an application with the relevant administrative department for industry and commerce for registration, and obtain a business license. The date on which the business license is issued shall be the date of the establishment of the said enterprise.

In the event that the foreign investor fails to file an application with the administrative department for industry and commerce for registration on the expiration of the 30 days after receiving the certificate of approval, the certificate of approval for the establishment of the proposed enterprise shall become invalid automatically.

A foreign-capital enterprise shall, within 30 days after its establishment, go through the procedures for taxation registration with the tax authorities.

Article 14 Foreign investors may appoint a Chinese service agency for enterprises with foreign investment or other economic organisations to handle, on their behalf, the affairs stipulated in Article 9, the first paragraph of Article 10 and Article 11 of these Rules, but a contract of entrustment shall be concluded and signed between them.

Article 15 The written application for the establishment of a foreign-capital enterprise shall include the following contents:

(1) The name or designation, the residence and the place of registration of the foreign investor, and the name, nationality, and position of the legal representative;

(2) The name and residence of the foreign-capital enterprise;

(3) The scope of business operations, the varieties of products, and the scale of production;

(4) The total amount of investment, the registered capital, the source of funds, and the method of investment contribution and the operation period;

(5) The organisational form and organs, and the legal representative of the foreign-capital enterprise;

(6) The primary production equipment to be used and the degrees of depreciation, production technology, technological level and their sources;

(7) The sales orientation and areas, the sales channels and methods, and the sales proportion between China's market and foreign markets;

(8) The arrangements for the revenues and expenditures in foreign exchange;

(9) The arrangements for the establishment of relevant organs of working personnel the engagement and use of workers and staff members, their training, salaries and wages, material benefits, insurance, and labour protection;
(10) The degrees of probable environmental pollution and the measures for tackling pollution;

(11) The selection of sites and the area of land to be used;

(12) The funds, energy resources, raw and processed materials needed in capital construction and in production and business operations and the solutions thereof;

(13) The progress plan for the construction of the project; and

(14) The period of business operations of the foreign-capital enterprise to be established.

Article 16 The articles of association of a foreign-capital enterprise shall include the following contents:

(1) The name and the residence;

(2) The aim and the scope of business operations;

(3) The total amount of investments, the registered capital, and the time limit for contributing investment;

(4) The form of organisation;

(5) The internal organisational structures and their functions and powers as well as their rules of procedures; the functions, duties and limits of powers of the legal

representative as well as of the general manager, chief engineer, chief accountant and other staff members;

(6) The principles and system of financial affairs, accounting and auditing;
(7) Labour administration;

(8) The term of business operations, termination, and liquidation; and

(9) The procedures for the amendment of the articles of association.

Article 17 The articles of association of a foreign-capital enterprise shall become effective after the approval by the examining and approving organ. The same procedure shall apply when amendments are made.

Article 18 The division or merge of foreign-capital enterprises, and the significant change in capital resulting from other causes, shall be subject to the approval by the examining and approving organ; in addition, the said enterprises shall engage a Chinese registered accountant to carry out verification, and to submit a report on the verification of capital; after the approval by the examining and approving organ, the enterprises concerned shall go through the procedures for the change of the registration with the relevant administrative department for industry and commerce.

Chapter III

Form of Organisation and Registered Capital

Article 19 The organisational form of a foreign-capital enterprise shall be a limited liability company. With approval, the enterprise may also take any other liability form.

With respect to a foreign-capital enterprise which is a limited liability company, the liability of the foreign investor to the enterprise shall be limited to the amount of investment subscribed and contributed to the enterprise by the investor.

With respect to a foreign-capital enterprise which takes any other liability form, the liability of the foreign investor to the enterprise shall be dealt with in accordance with the provisions of Chinese laws and regulations.

Article 20 The total amount of investment of a foreign-capital enterprise refers to the total amount of funds needed for the establishment of the enterprises, i. e. the sum total of the funds invested in capital construction in accordance with the scope of production and the circulating funds for production.

Article 21 The registered capital of a foreign-capital enterprise refers to the total amount of capital registered with the administrative department for industry and commerce for the purpose of establishing the foreign-capital enterprise, i. e the total amount of investment the foreign investor undertakes to contribute.

The registered capital of a foreign-capital enterprise shall fit in with the enterprise's scope of business operations; and the proportion between the registered capital and the total amount of investment shall conform with the provisions of the relevant Chinese laws and regulations.

Article 22 A foreign-capital enterprise shall not reduce the registered capital during the term of business operations.

Article 23 The increase or assignment of the registered capital of a foreign-capital enterprise shall be subject to approval by the examining and approving organ; in addition, the said enterprise shall go through the procedures for the change of the registration with the administrative department for industry and commerce.

Article 24 In case that a foreign-capital enterprise intends to mortgage or assign its assets or rights and interests to a foreign unit, the case shall be submitted to the examining and approving organ for approval, and then to the administrative department for industry and commerce for the record.

Article 25 The legal representative of a foreign-capital enterprise shall be the person-in-charge who, in accordance with the stipulations in the enterprise's articles of association, executes his/her functions and powers on behalf of the enterprise.

In the event that the legal representative is unable to execute his/her functions and powers, he/she shall entrust in writing an agent with the execution of his/her functions and powers.

Chapter IV

Methods of Contributing Investment and the Time Limit

Article 26 Foreign investors may use convertible foreign currencies for the contribution of investment, or use as their investment machinery and equipment, industrial property rights, and proprietary technology that are assigned a fixed price.

Foreign investors may, after approval by the examining and approving organ, use, as their investment, their profits in Renminbi (RMB) earned from other enterprises with foreign investment established within the territory of China.

Article 27 In case that foreign investors intend to use machinery and equipment, being assigned a fixed price, as their investment, the said machinery and equipment must meet the following requirements:

(1) Those that are needed for the production of the foreign-capital enterprise;

(2) Those that cannot be produced in China, or that can be produced in China but cannot be guaranteed to meet the needs in terms of technical performance or time of supply.

The price fixed for the aforesaid machinery and equipment shall not be higher than the normal price for similar machinery and equipment sold on the international market at the time.

With respect to the machinery and equipment, being assigned a fixed price and used as contributing investment, an inventory listing in detail the assigning of fixed prices as contributing investment, including the names, categories, quantities, and the assignment of prices, shall be made and submitted to the examining and approval organ as an appendix to the application for the establishment of the foreign-capital enterprise.

Article 28 In case that foreign investors intend to use industrial property rights and proprietary technology, being assigned a fixed price, as their investment, the said industrial property rights and proprietary technology must meet the following requirements:

(1) Owned by the foreign investors themselves;

(2) Capable of producing new products that are urgently needed by China, or that are suitable for export and marketable abroad.

The assigning of a fixed price for the aforesaid industrial property rights and proprietary technology shall be in conformity with the general pricing principles of the international market, and the amount of pricing thereof shall not exceed 20% of the registered capital of the foreign-capital enterprise.

With respect to those industrial property rights and proprietary technology, being assigned a fixed price for contributing investment, a detailed inventory of relevant data, including a duplicate of the proprietary rights certificate, the effective condition, technological performance, the practical value, the basis and standard for the calculation of pricing, shall be prepared and submitted to the examining and approving organ as an appendix to the application for the establishment of the foreign-capital enterprise.

Article 29 When the machinery and equipment, being assigned a fixed price and used as contributing investment, have arrived at China's port, the foreign-capital enterprise shall apply to China's commodity inspection authorities for inspection, which shall then issue an inspection report.

In the event that the variety, quality and quantity of the machinery and equipment, being assigned a fixed price and used as contributing investment, are not in conformity with the variety, quality and quantity of the machinery and equipment, being assigned a fixed price as contributing investment and listed in the inventory submitted to the examining and approving organ, the examining and approving organ has the power to require the foreign investors to make corrections within a prescribed time limit.

Article 30 After the industrial property rights and proprietary technology priced as contributing investment have been put to use, the examining and approving organ has the power to carry out inspection. In the event that the said industrial property rights and proprietary technology are not in conformity with the data originally provided by the foreign investors, the examining and approving organ has the power to require the foreign investors to make corrections within a prescribed time limit.

Article 31 The time limit for a foreign investor to make the investment contributions shall be clearly stipulated in the written application for the establishment of the foreign-capital enterprise and also in the articles of association of the enterprise. A foreign investor may make the investment contribution by instalments, but the last instalment of the contribution shall be made within the period of three years beginning from the day when the business license is issued. The first instalment of investment contribution shall not be less than 15% of the total amount of investment contribution that the foreign investor undertakes to make, and shall be made in full within a period of 90 days beginning from the day when the business license is issued.

In the event that a foreign investor fails to make in full the first instalment of the investment contribution within the time limit stipulated in the preceding paragraph, the certificate of approval for the establishment of the proposed foreign-capital enterprise shall become invalid automatically. The foreign-capital enterprise in question shall go through the procedure for registration cancellation with the relevant administrative department for industry and commerce, and hand in its business license for cancellation. In the event of the failure to go through the procedure for registration cancellation and to hand in the business license for cancellation, the administrative department for industry and commerce shall revoke the business license and announce the case publicly.

Article 32 After making the first instalment of investment contribution, the foreign investor shall make the remaining instalments of contribution strictly as scheduled. In the event that a foreign investor is in arrears with the contribution for 30 days without any justification, the case shall be handled in accordance with the provisions of paragraph 2 of Article 31 of these Rules.

In the event that a foreign investor has proper reasons for requesting the postponement of investment contribution, prior consent of the examining and approving organ shall be obtained, and the case shall also be reported to the administrative department for industry and commerce for the record.

Article 33 After the foreign investor's each instalment of investment contribution, the foreign-capital enterprise shall engage a Chinese registered accountant to carry out verification, and to prepare a report on the verification of capital, which shall be submitted to the examining and approving organ and the administrative department for industry and commerce for the record.

Chapter V

Use of Site and the Site Use Fees

Article 34 With respect to the site to be used by a foreign-capital enterprise, the local people's government at or above the county level in the place where the enterprise is to be located, shall make arrangements after examination and verification in the light of the local conditions.

Article 35 A foreign-capital enterprise shall, within 30 days from the day the business license is issued, go through the procedure for the use of land and obtain the land certificate by presenting the certificate of approval and the business license to the land administration department under the local people's government at or above the county level in the place where the enterprise is to be located.

Article 36 The land certificate shall be the legal instrument for the foreign-capital enterprise to use land. The foreign-capital enterprise within its term of operations, may not assign its land-use right without permission.
Article 37 A foreign-capital enterprise shall, when obtaining the land certificate, pay its land use fee to the land administrative department in the place where the enterprise is located.

Article 38 In case that a foreign-capital enterprise uses land that has already been developed, it shall pay the land development fee.

The land development fee , as mentioned in the preceding paragraph, includes the expense for the requisition of land, the expense for the pulling down of houses and the settlement allowance, and the expense for the construction of basic installations that match the foreign-capital enterprise. The land development fee may be calculated and collected by the land development unit in a lump-sum, or by yearly instalments.

Article 39 In case that a foreign-capital uses land that has not been developed, it may develop the land by itself, or it may entrust a department concerned in China to develop the land.

The infrastructure construction shall be carried out under the unified arrangement of the local people's government at or above the county level in the place where the enterprise is to be located.

Article 40 The standard for the calculation and collection of land use fee and land development fee shall be handled in accordance with pertinent provisions of China.

Article 41 The term for the use of land by a foreign-capital enterprise shall be the same as the approved operation period of the said enterprise.

Article 42 foreign-capital enterprise, besides obtaining the land-use right in accordance with the provisions of this Chapter, may also obtain the same right in accordance with the pertinent provisions of other Chinese laws and regulations.

Chapter VI

Purchasing and Marketing

Article 43 A foreign-capital enterprise shall formulate and execute its production and operation plans on its own; the said production and operation plans shall be submitted to the competent department in charge of the trade, in the place where the said enterprise is located, for the record.

Article 44 A foreign-capital enterprise is entitled to make decisions for itself on the purchase, for its own use, of machinery and equipment, raw and processed materials, fuels, parts and components, fittings, primary parts, means of transport, and articles for office use (hereinafter uniformly called "goods and materials").

A foreign-capital enterprise shall, when purchasing goods and materials in China under the same conditions, enjoy the same treatment as enjoyed by the Chinese enterprises.

Article 45 In case that a foreign-capital enterprise sells its products on the Chinese market, it shall conduct its sales in accordance with the approved sales proportion.

In the event that sales of products on the Chinese market by a foreign-capital enterprise exceed the approved sales proportion, the case shall be subjected to the approval by the examining and approving organ.

Article 46 A foreign-capital enterprise is entitled to export of its own accord, goods produced by itself; it may also appoint a Chinese foreign trade company or a company outside the territory of China to sell its goods on a commission basis.

A foreign-capital enterprise is entitled to sell, of its own accord, the products produced by itself on the Chinese market in accordance with the approved sales proportion; it may also appoint a Chinese commercial agency to sell its products on a commission basis.

Article 47 Where machinery and equipment being assigned a fixed price and use by foreign investors as contributing investment require, according to the pertinent provisions of China, import licenses, the foreign investors shall, on the strength of the approved inventory of equipment and goods and materials of the said enterprise to be imported, file an application directly, or through an agency entrusted by them, with the license-issuing organ for obtaining due import licenses.

Where a foreign-capital enterprise has to import, in accordance with the approved scope of business, goods and materials for its own use and needed by its production and if, according to the pertinent provisions of China, it is necessary for the said enterprise to obtain import licenses, it shall work out an annual plan for importation, and apply, every six months, to the license-issuing organ for the licenses.

With respect to products to be exported by a foreign-capital enterprise, if, according to the pertinent provisions of China, it is necessary for the said enterprise to obtain an export license, it shall work out an annual plan for exportation, and apply, every six months, to the license-issuing organ for the license.

Article 48 The prices of the goods and materials and technological labour service imported by a foreign-capital enterprise shall not be higher than the normal prices of similar goods and materials and technological labour service on the international market at the time. The price of export products produced by a foreign-capital enterprise shall be fixed by the enterprise itself with reference to the international market prices at the time, but the prices must not be lower that the reasonable export prices. With respect to the evasion of tax by using such methods a importing at high prices while exporting at low prices, the tax authorities shall have the power, in accordance with the pertinent provisions of the tax law, to investigate the legal responsibilities therefor.

The pricing of products to be sold by a foreign-capital enterprise on the Chinese market in accordance with the approved sales proportion shall be governed by the pertinent provisions of China concerning the administration of prices.

The pricing mentioned in the preceding paragraph shall be reported to the administrative authorities for prices and the tax authorities for the record, and shall be placed under their supervision.

Article 49 A foreign-capital enterprise shall provide statistical data and submit statistical statements to the departments concerned in accordance with the provisions in the Statistics Law of the People's Republic of China and the relevant provisions of China concerning the statistical system for the utilisation of foreign capital.

Chapter VII

Taxation

Article 50 A foreign-capital enterprise shall pay taxes and duties in accordance with the provisions of Chinese laws and regulations.

Article 51 The workers and staff members of a foreign-capital enterprise shall pay individual income tax in accordance with the provisions of Chinese laws and regulations.

Article 52 The following goods and materials imported by a foreign-capital enterprise shall be exempted from Customs duties and consolidated industrial and commercial tax;

(1) The machinery and equipment, parts and components, building materials as well as other materials used as investment by the foreign investor and needed for construction, as well as the installation and reinforcement of machinery;

(2) The machinery and equipment, parts and components, means of communications and transportation for use in production, and equipment for use in production and management, imported, for their own use, by a foreign-capital enterprise with the funds included in the total amount of investment;

(3) The raw materials and processed materials, auxiliary materials, primary parts, parts and components, and articles and materials for packaging imported by a foreign-capital enterprise for the production of export products.

In the event that the imported goods and materials, as mentioned in the preceding paragraph, are resold within the territory of China, or are used in the production of products to be sold within the territory of China, the foreign-capital enterprise concerned shall pay the taxes or make up the taxes in accordance with the provisions of the tax law of China.

Article 53 The export commodities produced by a foreign-capital enterprise, except those whose exportation is restricted by China, shall be exempted form Customs duties and consolidated industrial and commercial tax in accordance with the tax law of China.

Chapter VIII

Control of Foreign Exchange

Article 54 Foreign exchange affairs of a foreign-capital enterprise shall be handled in accordance with the pertinent laws and regulations of China concerning foreign exchange control.

Article 55 A foreign-capital enterprise shall, on the strength of the business license issued by the administrative department for industry and commerce, open an account at a bank which may handle foreign exchange business within the territory of China, and its receipts and payments in foreign exchange shall be subject to the supervision by the interested bank.

The foreign exchange revenue of a foreign-capital enterprise shall be deposited in the foreign exchange account of the bank where it has opened an account: and the foreign exchange expenses shall be paid from the foreign exchange account.

Article 56 A foreign-capital enterprise shall achieve by itself the balance of revenues and expenditures in foreign exchange.

In the event that a foreign-capital enterprise is unable to strike by itself the balance between revenue and expenditure in foreign exchange, the foreign investor shall indicate it clearly in the application for the establishment of the enterprise, and put forward a specific plan for solving the problem; the examining and approving organ shall give a reply after consultation with departments concerned.

In the event that the foreign investor has indicated in the application for the establishment of the foreign-capital enterprise, that the balance of revenue and expenditure in foreign exchange would be achieved by itself no government department shall be responsible for the solution of the balance problem of revenue and expenditure in foreign exchange for the said enterprise.

With respect to products, manufactured by a foreign-capital enterprise, urgently needed in China, capable of replacing similar imported goods, and permitted to be sold in China, the payments may be made in foreign exchange, subject to the approval by the Chinese administrative department for foreign exchange control.

Article 57 In case that a foreign-capital enterprise has the necessity to open a foreign exchange account at a bank outside the territory of China to meet the needs of production and business operations, the case shall be submitted the Chinese administrative department for foreign exchange control for approval and, in accordance with the provisions of the Chinese administrative department for foreign exchange control, regular reports on the conditions of revenues and expenditures in foreign exchange and statements of account shall be submitted.

Article 58 The wages and salaries as well as other rightful earnings in foreign exchange of foreign workers and staff members and of those form Hong Kong, Macao and Taiwan working in a foreign-capital enterprise may be remitted freely out of the country after taxes have been paid in accordance with the provisicns of the Chinese tax law.

Chapter IX

Financial Affairs and Accounting

Article 59 A foreign-capital enterprise shall, in accordance with Chinese laws, regulations and the provisions of financial organs, set up financial and accounting systems, which shall be reported, for the record, to the financial departments and the tax authorities at the place where the enterprise is located.

Article 60 The fiscal year of a foreign-capital enterprise shall begin from January 1 and end on December 31 of Gregorian calendar.

Article 61 Reserve funds and bonus and welfare funds for workers and staff members shall be withdrawn from the profits after a foreign-capital enterprise has paid income tax in accordance with the provisions of the Chinese tax law. The proportion of reverse funds to be withdrawn shall not be lower than 10% of the total amount of profits after payment of tax; the withdrawal of reserve funds may be stopped when the total cumulative reserve has reached 50% of the registered capital. The proportion of bonus and welfare funds for workers and staff members to be withdrawn shall be determined by the foreign-capital enterprise of its own accord.

In the event that deficits of previous fiscal years of a foreign-capital have not been made up, it may not distribute the profits, while the undistributed profits of previous fiscal year may be distributed together with the distributable profits of the current fiscal year.

Article 62 Accounting vouchers, account books and accounting statements made by a foreign-capital enterprise shall be written in the Chinese language; if they are written in a foreign language, notes in the Chinese language are required.

Article 63 Business accounting of a foreign-capital enterprise shall be conducted independently. The annual accounting statements and liquidation accounting statements of a foreign-capital enterprise shall be prepared in accordance with the provisions of the Chinese competent departments for financial and tax affairs. If accounting statements are prepared in foreign currencies, accounting statements in which the foreign currencies are converted into Renminbi (RMB) shall be prepared at the same time.

The annual accounting statements and liquidation accounting statements of a foreign-capital enterprise, as stipulated in the second and third paragraphs of this Article, together with the verification report prepared by a Chinese registered accountant, shall be submitted, within a prescribed time limit, to the China competent departments for financial and tax affairs and also to the examining and approving organ and the administrative department for industry and commerce for the record.

Article 64 The foreign investor may engage Chinese or foreign accounting personnel to consult the account books of a foreign-capital enterprise, and the expenses thus entailed shall be borne by the foreign investor.

Article 65 A foreign-capital enterprise shall submit its annual statement of assets and liabilities and annual statement of profit and loss to the competent departments for financial and tax affairs, and also to the examining and approving organ as well as the administrative department for industry and commerce for the record.

Article 66 A foreign-capital enterprise shall set up account books at the place where the said enterprise is located, and shall receive supervision of the competent departments for financial and tax affairs.

With respect to any foreign-capital enterprise which violates the provisions in the preceding paragraph, the competent departments for financial and tax affairs may impose a fine, and the administrative department for industry and commerce may order to suspend its business operations or revoke its business license.

Chapter X

Workers and Staff Members

Article 67 In case that a foreign-capital enterprise employs workers and staff members within the territory of China, both the enterprise and the workers and staff members shall, in accordance with the Chinese laws and regulations, conclude and sign a labour contract. Matters as employment, dismissal, salaries and wages, welfare labour protection and, labour insurance shall be clearly stipulated in the contract.

Foreign-capital enterprises may not hire child labourers.

Article 68 The workers and staff members of a foreign-capital enterprise shall have the right to set up a grass-roots trade union organisation and carry out trade union activities in accordance with the provisions of the Trade Union Law of the People's Republic of China.

Chapter XI

Trade Union

Article 69 The workers and staff members of a foreign-capital enterprise shall have the right to set up a grass-roots trade union organisation and carry out trade union activities in accordance with the provisions of the Trade Union Law of the People's Republic of China.

Article 70 The trade union in a foreign-capital enterprise shall represent the interests of workers and staff members, and have the right to conclude labour contracts with the enterprise on their behalf, and to supervise the execution of the labour contracts.

Article 71 The basic tasks of the trade union in a foreign-capital enterprise shall be as follows: to safeguard the lawful rights and interests of workers and staff members in accordance with the provisions of Chinese laws and regulations, and to assist the enterprise in the rational arrangements and use of welfare and bonus funds for the workers and staff members; to organise workers and staff members in carrying on political study, in learning scientific, technical and professional knowledge, in carrying out cultural, artistic and sports activities; to educate workers and staff members in complying with labour discipline and in striving to fulfil various economic tasks of the enterprise.

When a foreign-capital enterprise holds discussions on problems concerning the commendation and punishment of workers and staff members, the wage system, welfare benefits, labour protection and labour insurance, representatives of the trade union shall have the right to attend the discussions as nonvoting attendants. A foreign-capital enterprise shall listen to the opinions of the trade union, and win its co-operation.

Article 72 A foreign-capital enterprise shall give an active support to the work of the trade union of the enterprise, and, in accordance with the provisions of the Trade Union Law of the Peoples' Republic of China, provide the trade union organisation with the necessary houses and equipment for handling trade union work, holding meetings and conducting such collective undertakings as welfare benefits, and sports activities for workers and staff members. Every month, the enterprise shall appropriate a sum equal to 2% of the actual total amount of wages and salaries of workers and staff members to the trade union as outlay, and the trade union of the enterprise shall use this sum of money in accordance with the measures for the administration of trade union outlay, as formulated by the All-China Federation of Trade Unions.

Chapter XII

Term of Operations, Termination and Liquidation

Article 73 The term of operations of a foreign-capital enterprise shall be proposed by the foreign investor in the written application for the establishment of the enterprise in the light of the specific conditions of different enterprises, and shall be subjected to the approval by the examining and approving organ.

Article 74 The term of operations of a foreign-capital enterprise shall be calculated form the day when the business license is issued.

In the event that the term of operations of a foreign-capital enterprise has to be extended upon its expiration, the enterprise shall, 180 days before the expiration of the term of operations, file an application for the extension of the term of operations with the examining and approving organ. The examining and approving organ shall, within 30 days from the day of receiving the application, determine whether to approve or disapprove the extension.

The foreign-capital enterprise shall, after obtaining the approval for an extension of its term of operations and within 30 days from the day of receiving the approval for the extension, go through the procedure for the change of registration with the administrative department for industry and commerce.

Article 75 A foreign-capital enterprise that falls under one of the following circumstances shall terminate its business operations:

(1) The term of operations expires;

(2) The foreign investor decides to dissolve it because of poor operation and management resulting in serious losses;

(3) Business cannot be carried on because of heavy losses as a result of natural disasters, wars or other force majeure;

(4) Bankruptcy;

(5) Disbanded by law because it has violated Chinese laws and regulations or jeopardised social and public interests;

(6) Other causes for dissolution, as stipulated in the enterprise's articles of association, have occurred.

If a foreign-capital enterprise falls under any of the circumstances as stipulated in Items (2), (3) and (4) of the preceding paragraph, it shall submit, of its own accord, an application for the termination of business operations to the examining and approving organ for verification and approval. The date of approval after verification by the examining and approving organ shall be the date of the said enterprise's termination.

Article 76 In case that a foreign-capital enterprise terminates its business operations in accordance with the provisions in Items (1), (2), (3) and (6) of Article 75, the enterprise shall, make a public announcement and notify the creditors; and, it shall, within 15 days from the day of the public termination announcement for liquidation, the principles of liquidation, and the candidates for the liquidation committee to the examining and approving organ for verification and approval before liquidation is carried out.

Article 77 The liquidation committee shall be composed of the legal representatives of the foreign-capital enterprise, the representatives of the creditors, the representatives from the competent authorities concerned; Chinese registered accountants and lawyers shall be engaged in the liquidation.

Priority shall be given to the payment of expenses for liquidation made from the existing property of the foreign-capital enterprise.

Article 78 The liquidation committee shall execute the following functions and powers:

(1) To convene a meeting of creditors;

(2) To take over and liquidate the property of the enterprise in question, and to prepare the statement of assets and liabilities and the inventory of property;

(3) To propose a basis for the valuation and computation of the property of the enterprise in question;

(4) To work out a liquidation plan;

(5) To recover creditor's rights and to pay the debts;

(6) To receive the payments from shareholders which have not yet been made;

(7) To distribute the remaining property;

(8) To represent the foreign-capital enterprise in bringing a suit or responding to a suit.

Article 79 Prior to the conclusion of the liquidation of foreign-capital enterprise, the foreign investor shall not remit or carry the said enterprise's funds out of the territory of China, nor dispose of the enterprise's property privately.

If, upon the conclusion of the liquidation of a foreign-capital enterprise, its net assets and remaining property exceed its registered capital, the excess portion shall be regarded as profit on which income tax shall be imposed in accordance with the Chinese tax law.

Article 80 Upon the conclusion of the liquidation of a foreign-capital enterprise, it shall go through the procedures for the cancellation of registration with the administrative department for industry and commerce, and to hand in the business license for cancellation.

Article 81 While disposing of the assets and properties of a foreign-capital enterprise, Chinese enterprises or other economic organisations shall, under equal conditions, have the priority in purchasing the aforesaid assets and properties.

Article 82 In case that a foreign-capital enterprise terminates its business operations in accordance with the provisions in Item (4) of Article 75, its liquidation shall be carried out with reference to the pertinent laws and regulations of China.

Chapter XIII

Supplementary Provisions

Article 83 With respect to the various categories of insurance for a foreign-capital enterprise, it shall take out insurance from insurance companies within the territory of China.

Article 84 If a foreign-capital enterprise concludes economic contracts with any other Chinese enterprise or economic organisation, the Economic Contract Law of the People's Republic of China shall be applied.

If a foreign-capital enterprise concludes economic contracts with any foreign company, enterprise or individual, the Law of the People's Republic of China on Economic Contracts Involving Foreign Interests shall be applied.

Article 85 Cases concerning the establishment, in China's mainland, of enterprises, the capital of which is owned solely by the companies, enterprises, and other economic organisations or individuals in the regions of Hong Kong, Macao or Taiwan, or by Chinese citizens residing in foreign countries, shall be handled with reference to these Rules.

Article 86 Foreign workers and staff members, and workers and staff members from Hong Kong, Macao and Taiwan, who are working in a foreign-capital enterprise, may carry into the country means of transport and articles for daily use that are within reasonable quantities and for their own use, and they shall go through the import procedures in accordance with pertinent provisions of China.

Article 87 The right to interpret these Rules shall reside in the Ministry of Foreign Economic Relations and Trade.

Article 88 These Rules shall go into effect as of the date of promulgation.

Appendix 6.3

Interim Provisions on Guidance for Foreign Investment

(Jointly promulgated by Decree No.5 of the State Planning Commission, the State Economic and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation on June 20, 1995)

Article 1 The following provisions are formulated in accordance with the stipulations of state laws related to foreign investment and the requirements of relevant industrial policies in order to guide foreign investment, adapt foreign investment to China's national economic and social development programs, and adequately protect the legal rights and interests of investors.

Article 2 The provisions are applicable to projects involving Sino-foreign joint ventures, cooperative ventures and solely foreign-funded enterprises, as well as other forms of projects involving foreign funding (hereinafter referred to as foreign-funded projects).

Article 3 The State Planning Commission, acting in concert with relevant State Council departments, will regularly compile and intermittently amend the Industrial Catalogue Guiding Foreign Investment (hereinafter referred to as the Catalogue) in accordance with the provisions and national economic and technological development. The Catalogue will be released with the approval of the State Council.

The Catalogue shall serve as the basis for guiding the examination and approval of foreign-funded projects.

Article 4 Projects involving foreign investment shall be divided into four categories: Projects in which foreign investment shall be encouraged, permitted, restricted or prohibited (hereinafter referred to as Group I, Group II, Group III, and Group IV).

Projects in which foreign investment shall be encouraged, restricted or prohibited are listed in the Catalogue. Remaining projects in which foreign investment shall be permitted are not listed in the Catalogue.

The Catalogue may explicitly list projects in which exclusive foreign investment shall not be allowed and projects in which state-owned assets shall take a controlling or dominant position.

Article 5 Projects in which foreign investment shall be encouraged are as follows:

(1) Projects involving new agricultural technology, comprehensive agricultural development and the development of energy, communications and essential raw materials;

(2) Projects involving new, high and advanced technology, improved products, energy and raw materials conservation, enhanced technological and economic returns of enterprises, or the production of new equipment and materials with high market demand which remains unfulfilled due to inadequate domestic production capacity;

(3) Projects which meet the demand of international market, and help raise the grade of products, open new markets, expand overseas marketing of products and increase the export volume;

(4) Projects involving new technologies and new equipment for the comprehensive use of resources and renewable resources, and the prevention and control of environmental pollution;

(5) Projects which tap the advantages of human and natural resources in China's central and western regions, and which fulfil the requirements of State industrial policies;

(6) Other projects encouraged by stipulations of State laws and administrative rules and regulations.

Article 6 Projects in which foreign investment shall be restricted are as follows:

(1) Projects already developed nationally or those which have absorbed technology and developed a production capacity capable of fulfilling demand on the domestic market;

(2) Sectors in which foreign investment is absorbed by the state on a trial basis or monopolistic industries;

(3) Exploration and exploitation of rare and valuable mineral resources;

(4) Industries subject to overall State planning;

(5) Other projects restricted by stipulations of State laws and administrative rules and regulations.

Projects in which foreign investment shall be restricted are classified as Category A or Category B in accordance with State industrial policies and the requirements of macro-economic control.

Article 7 Projects in which foreign investment shall be prohibited are as follows:

(1) Projects which jeopardise state security or harm public interest;

(2) Projects which create environmental pollution, damage natural resources or threaten the health of the people;

(3) Those which occupy large tracts of arable land or are otherwise unfavourable to the protection and development of land resources, as well as those which are detrimental to the safety and the efficiency of the use of military installations;

(4) Projects involving products made with the country's specific technical processes or technology;

(5) Other projects prohibited by stipulations of State laws and administrative rules and regulations.

Companies, enterprises, other economic entities and individuals are prohibited from setting up projects listed in the preceding article.

Article 8 Apart from enjoying preferential treatment in accordance with relevant State laws and administrative rules and regulations, when approved, projects in which foreign investment is encouraged shall be permitted to expand their pertinent business scope if they involve the construction and management of energy and communications facilities (coal mining, power generation, regional railway, highway and port facilities) which require large investments and long-term recovery of investment.

Article 9 Projects in which foreign investment is restricted shall observe relevant State laws and administrative rules and regulations, and shall be subject to the following provisions:

(1) In cases involving Sino-foreign joint ventures, time limits for operations shall be agreed upon between pertinent parties;

(2) In cases involving foreign-funded projects listed in Category A, the fixed assets invested by the Chinese party shall be funds or assets owned by the Chinese investor.

Article 10 Projects in which foreign investment is encouraged or permitted shall be examined, approved and put on file according to procedures stipulated in working regulations.

Foreign-funded projects listed in Category A shall be examined, approved and put on file in accordance with procedures stipulated in working regulations. In cases when investment projects in Category A are below the examination and approval level determined by the State Council, such projects shall, in accordance with their construction characteristics, be examined and approved by the planning department or department in charge of the technical renovation of enterprises in related provinces, autonomous regions, municipalities directly under the Central Government or cities listed separately in state budget. The examination and approval of such projects shall not be granted to departments at lower levels.

Should the level of investments of projects in Category B be below the examination and approval level determined by the State Council, the letter of proposal for such projects shall be examined and approved by the department assigned by the State Council to take charge of the specific trade sector, while the feasibility study report shall, in accordance with their characteristics of construction, be examined and approved by the planning department or the department in charge of the technical renovation or enterprises in related provinces, autonomous regions, municipalities directly under the Central Government or cities listed separately on State plans. A report shall be submitted to the State Planning Commission or the State Economic and Trade Commission for record. The responsibility for examining and approving such projects shall not be transferred to any department at a lower level. However, in cases when investments in projects surpass the examination and approval level determined by the State Council, examination and approval shall be carried out in accordance with the procedures and methods in force.

Projects involving quotas or licenses shall apply for the quotas or licenses required from departments in change of foreign trade and economic cooperation.

Additional stipulations on the procedures and methods for project examination and approval provided in relevant laws or administrative decrees or regulations shall be observed.

Article 11 In cases when foreign-funded projects in the category described in Article 6, Clause 1, export more than 70 percent of their products, when approved, such projects shall be treated as those in which foreign investment is permitted and shall not be subject to restrictions outlined in Article 9. Controls may be appropriately lifted on projects which take full advantage of the superior resources in China's central and western regions and which at the same time operate in accordance with state industrial policies.

Article 12 With regard to foreign-funded projects in violation of these provisions, departments examining and approving such projects shall cancel their approvals within 30 days after receiving documents of record concerning projects concerned. The articles of association and contract of such projects shall be invalidated, enterprise registration departments shall refuse or cancel registration, and custom houses shall reject import or export procedures.

Article 13 Any party which uses deceit or other illegal means to win approval of foreign-funded project shall bear legal responsibility in accordance with law and in line with the seriousness of the case. At the same time, the examination and approval organ shall revoke the approval. The case shall be adjudicated by the responsible department in accordance with law.

Article 14 Members of the staff of a department responsible for examination and approval found to have abused their power and position, resorted to fraud for personal gain, neglected their prescribed duties, or otherwise overstepped their authority shall be subject to administrative discipline or shall be held criminally responsibility in accordance with the law if the case is extremely serious and falls into requisites to constitute a crime.

Article 15 Projects funded by overseas Chinese, Hong Kong, Macao and Taiwan investors shall be treated in accordance with the aforementioned provisions.

Article 16 The State Planning Commission, the State Economic and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation shall be responsible for organising implementation of these provisions.

Article 17 These Provisions shall go into effect on the date of promulgation.

Appendix 6.4

State Council, Foreign Investment in Retailing Provisions

(Announced on 23 November 1992)

The State Council formulated the following Provisions permitting Beijing, Shanghai, Tianjin, Guangzhou, Dalian and Qingdao municipalities and the five Special Economic Zones to allow foreign investment in retailing on a trial basis.

1. Enterprises shall take the form of co-operative or equity joint ventures. For the time being, the form of wholly owned enterprise may not be adopted.

2. Projects shall be submitted for examination and approval to the State Council by local governments. The qualifications of the Chinese and foreign parties to the joint ventures shall be examined by the Ministry of Commerce.

3. The scope of business shall be restricted to the commercial business of retailing general merchandise and import and export. Enterprises may not engage in commercial wholesaling or import and export agency.

4. Imports shall be restricted to general merchandise of the enterprises. Their import volume in any given year may not exceed 30% of their total retail sales for that year. The import of household electrical appliances, cosmetics, cigarettes and alcoholic and other beverages shall be subject to examination and approval in accordance with the relevant regulations of the State. Category 1 merchandise may not be exported. With respect to dealings in merchandise of Categories 2 and 3, merchandise which is listed in plans or require quota permits shall be reported for examination and approval to the Ministry of Foreign Economic Relations and Trade on an annual basis.

5. Taxation shall be handled in accordance with the State's taxation policy for foreign investment enterprises in the place where the enterprises are located.

6. Purchase and sales prices of merchandise may be fixed autonomously, except if the national or local commodity price authorities provide otherwise. Subject to the approval of the foreign exchange authorities of the State, prices for imported merchandise may be charged in Foreign Exchange Certificates.

Appendix 6.5

Regulations of the State Council for Encouraging Investment from Overseas Chinese and Compatriots from Hong Kong and Macao

(Promulgated on August 19,1990)

Article 1 The present Regulations are enacted to stimulate China's economic development and encourage investment within the territory of mainland from overseas Chinese and compatriots from Hong Kong and Macao (hereinafter referred to as overseas Chinese, Hong Kong and Macao investors).

Article 2 Overseas Chinese, Hong Kong and Macao investors may invest in any province, autonomous region, municipality and Special Economic Zones in the mainland.

Overseas Chinese, Hong Kong and Macao investors are encouraged to undertake land development and management in accordance with relevant State regulations.

Article 3 Overseas Chinese, Hong Kong and Macao investors may invest in the mainland in any of the following ways:

(1) To establish wholly-owned enterprises;

(2) To establish equity or contractual joint ventures;

(3) Undertaking compensation trade, processing or assembling with supplied materials, co-production;

(4) Purchasing enterprise shares and bonds;

(5) Buying real estates;

(6) Obtaining the rights of land use according to law and undertaking land development and management;

(7) Any other form permitted by laws and regulations.

Article 4 Overseas Chinese, Hong Kong and Macao investors may invest in industry, agriculture, service trades and other industries that conform to the direction of social and economic development. They may choose the investment projects promulgated by the relevant departments of local people's government, or may put forward their own investment plans and apply to the departments of foreign economic relations and trade or examination and approval authorities under the people's government of the localities where they intend to invest.

The State encourages overseas Chinese, Hong Kong and Macao investors to establish export enterprises and technologically-advanced enterprises and grants them corresponding preferential treatment.

Article 5 In addition to treatment laid down in these Regulations, wholly-owned enterprises, equity joint ventures or contractual joint ventures which are established by overseas Chinese, Hong Kong and Macao investors, may enjoy the corresponding preferential treatment given to enterprises with foreign investment in accordance with the state laws and regulations.

Except these Regulations, the State laws and rules concerning foreign economic affairs are applicable to overseas Chinese, Hong Kong and Macao investors investing in other forms and having no business offices in the mainland but receiving dividends, interests, rentals, royalties and other incomes from the mainland.

Article 6 Overseas Chinese, Hong Kong and Macao investors may contribute convertible currencies, machinery and equipment of in kind, industrial property rights or know-how, etc. as their investment.

Article 7 The investment by overseas Chinese Hong Kong and Macao investors, assets bought by them, industrial property rights, profits from their investment and their other lawful rights and interests in the mainland are protected by the state law and may be transferred and inherited according to law.

All the activities in the mainland of overseas Chinese, Hong Kong and Macao investors shall be governed by the state laws and regulations.

Article 8 The state shall not nationalize any investment made by overseas Chinese, Hong Kong and Macao investors or other assets bought by them.

Article 9 In case the state expropriates enterprises with overseas Chinese, Hong Kong and Macao investment, based on the social need of public interest, this shall be done according to legal procedures and appropriate compensation shall be paid.

Article 10 The legitimate profits from overseas Chinese, Hong Kong and Macao investors' investment, their other lawful incomes and funds after liquidation may be remitted from the mainland pursuant to the law.

Article 11 Machines and equipment, vehicles used in production and office equipment that the enterprises with overseas Chinese, Hong Kong and Macao investment need to import and within the total investment, and appropriate volumes of daily necessities and vehicles of overseas Chinese, Hong Kong and Macao compatriots for private use while working in the enterprises shall be exempted from import duty and the consolidated industrial and commercial tax, and from the requirement for import licences.

Raw materials, fuel, bulk parts, spare parts, machine component parts and fittings that enterprises with overseas Chinese, Hong Kong and Macao investment need to import for export-oriented production shall be exempt from import duty and the consolidated industrial and commercial tax, and from the requirement for import licences. The Customs departments shall exercise the supervision and control. If the imported materials and items mentioned above are used in products to be sold in the mainland, import formalities shall be handled according to the relevant regulations, and taxes shall be paid according to the governing sections of laws and regulations.

Products manufactured to be exported by the enterprises with overseas Chinese, Hong Kong and Macao investment, except those restricted by the state, shall be exempt from export duty and the consolidated industrial and commercial tax.

Article 12 Enterprises with overseas Chinese, Hong Kong and Macao investment may acquire loans from financial institutions in or outside the mainland. The loans may be mortgaged and guaranteed with the enterprise assets, rights and interests.

Article 13 The term of operation of enterprises wholly-owned by overseas Chinese, Hong Kong and Macao investors shall be decided by the investors; the term of operation of equity joint ventures or contractual joint ventures shall be determined through consultation by the parties to joint ventures or may not be determined.

Article 14 The composition of the board of directors of an equity joint venture and the appointment of its chairman, and the composition of the board of directors or the joint managerial institution of a contractual joint venture and the appointment of its chairman or director shall be determined through consultation by the partners according to the proportion of investment or conditions for cooperation.

Article 15 Enterprises with overseas Chinese, Hong Kong and Macao investment shall conduct operational and managerial activities in accordance with its contract, articles of association approved. Its rights of autonomous management shall not be interfered with.

Article 16 Overseas Chinese, Hong Kong and Macao investors and technical and managerial staff employed outside the mainland by enterprises with overseas Chinese, Hong Kong and Macao investment any apply for multiple entrance visas.

Article 17 In investing in the mainland, overseas Chinese, Hong Kong and Macao investors may entrust their relatives or friends in the mainland as their agents. Such agents shall hold letters of entrustment with legal force.

Article 18 In the areas where enterprises with overseas Chinese, Hong Kong and Macao investment are concentrated, the investors may apply to the local people's government for the founding of businessmen association of overseas Chinese, Hong Kong and Macao.

Article 19 The application of the establishment of an equity joint venture or a contractual joint venture with overseas Chinese, Hong Kong and Macao investment in the mainland shall be handled by the participant in the mainland, the application for the establishment of an enterprise wholly owned by a overseas Chinese, Hong Kong and Macao investor may be handled by the investor directly or by the investor's relatives and friends or consultant service agencies in the mainland entrusted by the investor. All the application above mentioned shall be submitted to the local department of foreign economic relations and trade or the examination and approval authority under the local people's government.

The examination and approval of an enterprise with overseas Chinese, Hong Kong and Macao investment is subject to the authority limited by the State Council. The departments of foreign economic relations and trade at all levels or the examination and approval authorities under the local people's government shall, within 45 days after receiving all application documents, make a decision of approval or not.

The applicants shall, within 30 days after the receipt of the certificate of approval, apply to the administrations for industry and commerce for registration and obtain a business license in light of relevant procedures for registration and administration.

Article 20 Disputes between the parties arising over the execution of the contract or concerning the contract shall be settled through possible friendly consultation or mediation.

In the event that the parties are unwilling to settle their dispute through consultation or mediation, or bring about no results after consultation or mediation, any party to the dispute may submit it for arbitration to the Chinese or other arbitration agencies in accordance with the arbitration clause in the contract or a written arbitration agreement concluded after the dispute.

Any party may bring their case to a Chinese court, if no arbitration clause is laid down in the contract and if no written arbitration agreement is concluded after the dispute.

Article 21 The right of the interpretation of these Regulations resides in the Ministry of Foreign Economic Relations and Trade.

Article 22 These Regulations shall enter into force on the date of promulgation.

Appendix 6.6

Law of the People's Republic of China on the Protection of Investment of Taiwan Compatriots

(Adopted at the Sixth Meeting of the Standing Committee of the Eighth National People's Congress on March 5, 1994, promulgated by Order No.20 of the President of the People's Republic of China on March 5, 1994 and effective as of the date of promulgation)

Article 1 This Law is formulated for the purpose of protecting and encouraging investment of Taiwan compatriots, and promoting the economic development on both sides of the Straits.

Article 2 Investment of Taiwan compatriots shall be governed by this Law. In respect of matters concerning investment of Taiwan compatriots not covered by this Law, where there are provisions thereon in other relevant laws and administrative rules and regulations of the State, such provisions shall apply.

"Investment of Taiwan compatriots" as used in this Law means investment made in other provinces, autonomous regions or municipalities directly under the Central Government by the companies, enterprises, other economic organisations or individuals from the region of Taiwan as investors.

Article 3 The State shall, according to law, protect the investments, investment returns and other lawful rights and interests of investors who are Taiwan compatriots.

Taiwan compatriots in making investment must abide by laws and administrative rules and regulations of the State.

Article 4 The State shall not nationalise or requisition the investment made by investors who are Taiwan compatriots; under special circumstances and on the basis of the need of public interests, the State may in accordance with legal procedures requisition the investments made by investors who are Taiwan compatriots and make appropriate compensations thereto.

Article 5 The invested properties, industrial property rights, investment returns and other lawful rights and interests of investors who are Taiwan compatriots may be transferred and inherited according to law.

Article 6 Investors who are Taiwan compatriots may make investment with convertible currency, machinery equipment or other physical assets, industrial property rights or non-patented technologies, etc.

Investors who are Taiwan compatriots may make reinvestment with the returns derived from their investment.

Article 7 Taiwan compatriots may make investment by establishing equity joint ventures, contractual joint ventures or enterprises with all capital invested by Taiwan compatriots (hereinafter generalised as enterprises with investment of Taiwan compatriots) or may also invest in other forms as provided by laws or administrative rules and regulations.

The establishment of enterprises with investment of Taiwan compatriots shall be in conformity with the industrial policy of the State and conducive to the development of the national economy.

Article 8 To establish an enterprise with investment of Taiwan compatriots, an application shall be made to the department prescribed by the State Council or to the local people's government prescribed by the State Council. The examining and approving authorities that have received the application shall, within 45 days from the date of receiving all the documents for the application, decide whether or not to grant approval.

After an application for the establishment of an enterprise with investment of Taiwan compatriots has been approved, the applicant shall, within 30 days from the date of receiving the certificate of approval, register its establishment with the enterprise registration authorities and obtain a business licence according to law.

Article 9 Enterprises with investment of Taiwan compatriots shall carry out their activities of operation and management in accordance with the law, administrative rules and regulations as well as the contract and articles of association approved by the examining and approving authorities, and their decision-making power in operation and management shall be free from interference.

Article 10 In areas where enterprises with investment of Taiwan compatriots are located in compact forms, an association of enterprises with investment of Taiwan compatriots may be established according to law and its lawful rights and interests shall be protected by law.

Article 11 Investors who are Taiwan compatriots may remit in accordance with law their legal returns from investment, other lawful earnings and funds after settlement of accounts back to Taiwan or outside of the territory of the People's Republic of China.

Article 12 Investors who are Taiwan compatriots may entrust their relatives or friends to act as agents to act as agents for their investment.

Article 13 Enterprises with investment of Taiwan compatriots shall enjoy preferential treatment in accordance with the relevant provisions of the State Council on encouraging investment of Taiwan compatriots.

Article 14 With respect to disputes over investment arising between investors who are Taiwan compatriots and companies, enterprises, other economic organisations or individuals in other provinces, autonomous regions or municipalities directly under the Central Government, the parties concerned may settle them through consultation or mediation.

Where the parties concerned are not willing to resort to consultation or mediation, or where consultation or mediation proves unsuccessful, they may, in accordance with the arbitration clause in the contract or the written arbitration agreement reached subsequently, submit the matter to an arbitration organ for arbitration.

Where there is no arbitration clause in the contract, and no written arbitration agreement reached subsequently, the parties concerned may bring a suit to the people's court.

Article 15 This Law shall go into effect on the date of promulgation.

Appendix 6.7

Experimental Measures on Commercial Foreign-Invested Enterprises

Issued by the State Economic and Trade Commission and the
Ministry of Foreign Trade And Economic Cooperation

These Measures, promulgated on June 25, 1999, were formulated in accordance with the PRC Sino-Foreign Equity Joint Venture Law, the PRC Sino-Foreign Cooperative Joint Venture Law, and other relevant laws and regulations to promote reform and development of commercial enterprises and the domestic consumer market, and to facilitate experimentation with the use of foreign investment in the commercial sector.

The Measures sanction the creation of Sino-foreign equity or cooperative joint ventures, but not wholly foreign-owned investments, in the PRC's retail and wholesale markets. They permit the establishment of joint venture commercial outlets in provincial capitals, the capitals of autonomous regions, and special economic zones, as well as in Beijing, Tianjin, Shanghai, Chongqing and municipalities granted provincial status by the State. In addition to retail business, wholesale activities may be conducted by approved joint venture commercial enterprises in any of these geographical areas.

A foreign party to a joint venture commercial enterprise must demonstrate that it possesses financial strength, advanced commercial operations, management expertise, an extensive international sales network, a sound reputation and the ability to promote the export of Chinese products through the joint venture.

In order to apply for the establishment of a retailing joint venture, the foreign party must have:

(i) average yearly sales turnover of at least US$2 billion during the three years prior to the date of application, and

(ii) assets of more than US$200 million during the year prior to the date of application.

For a wholesaling joint venture, the foreign party must have:

(i) average yearly sales turnover of at least US$2.5 billion during the three years prior to the date of application, and

(ii) assets of more than US$300 million during the year prior to the date of application. The Chinese party to a joint venture commercial enterprise must be a qualified distributor demonstrating financial strength and solid operating capacity. In addition, it must satisfy certain conditions as follows:

- It must have assets for the year preceding the date of application of not less than 50 million yuan (30 million yuan if in central or western China).

- If the Chinese party is a commercial enterprise, it must have an average yearly sales turnover of at least 300 million yuan during the three years prior to the date of application (200 million yuan if in central or western China).

- If the Chinese party is a corporation with foreign trade privileges, its average yearly import and export turnover (on its own account) for the three years immediately prior to the date of application must be more than US$50 million. Of this, the export volume must be at least US$30 million.

A joint venture commercial enterprise must observe the following conditions and requirements:

- For retail joint ventures, registered capital must be at least 50 million yuan (30 million yuan in central and Western China).

- For wholesale joint ventures, registered capital must be at least 80 million yuan (60 million yuan in central and Western China).

- For wholesale joint ventures, the Chinese party's investment stake must be at least 51 percent.

- For joint ventures with three or fewer chain stores, including convenience stores, specialty stores, and franchise stores that operate as chain stores, the Chinese party's investment stake must be at least 35 percent.

- In joint ventures with three or more chain stores, the Chinese party's investment stake must be at least 51 percent. However, for joint ventures where the foreign party has procured large quantities of domestic products and is able to expand domestic exports via its international marketing network, the foreign party may be permitted to be the controlling shareholder, subject to State Council approval.

- The joint venture may establish branch stores only in the form of direct chain stores which are directly invested in and operated by the joint venture.

- The operating term shall not be more than 30 years (40 years for those in central or Western China).

- In the case of a trademark, trade name, or technology transfer contract, the fees paid to the foreign party shall not exceed 0.3 percent of the joint venture's annual sales turnover (excluding Value-added Tax).

- A joint venture commercial enterprise may not engage in commodity importing or act as an export agent.

- The total annual amount of imports of a joint venture shall not exceed 30 percent of its commodity sales volume for the same year.

For retail joint ventures, the permitted business scope includes:

(i) commercial retailing,

(ii) organising the export of domestically produced products

(iii) import and export of commodities on its own account, and

(iv) relevant ancillary services.

A joint venture engaged in retail sales may, upon approval, carry out wholesaling as its secondary business. For wholesale joint ventures, the permitted business scope includes:

(i) wholesaling of domestically produced and imported commodities on its own account, and

(ii) organising the export of domestically produced products.

In order to obtain approval for the establishment of a joint venture commercial enterprise, the Chinese party must first submit a feasibility study report to the local Economic and Trade Commission which, together with the local bureau of internal trade, submits the report to the central-level State Economic and Trade Commission ("SETC"). SETC may approve the feasibility study report after consulting the Ministry of Foreign Trade and Economic Cooperation ("MOFTEC"). Once the feasibility study report is approved, the local foreign economic and trade department submits the joint venture contract and articles of association, together with other required documents, to MOFTEC for approval. Within one month of MOFTEC approval, the joint venture must register with the local administration of industry and commerce on the basis of its MOFTEC approval certificate.

If an established joint venture commercial enterprise wishes to engage in wholesaling as its secondary business, open branch offices, or transfer an interest in the joint venture, it must apply to MOFTEC, which will make its determination in consultation with SETC. MOFTEC and SETC or their authorised institutions shall supervise and administer regulation of foreign-invested commercial enterprises in accordance with PRC laws and regulations.

Appendix 6.8

The Law of the People's Republic of China on Chinese-Foreign Joint Ventures

(Adopted by the Second Session of the Fifth National People's Congress on July 1, 1979 and Promulgated on and Effective as of July 8, 1979)

Article 1.

With a view to expanding international economic co-operation and technical exchange, the People's Republic of China permits foreign companies, enterprises, other economic organisations or individuals (hereafter referred to as "foreign joint venturers") to join with Chinese companies, enterprises or other economic organisations (hereafter referred to as "Chinese joint venturers") in establishing joint ventures in the People's Republic of China in accordance with the principle of equality and mutual benefit and subject to approval by the Chinese Government.

Article 2.

The Chinese Government protects, in accordance with the law, the investment of foreign joint venturers, the profits due them and their other lawful rights and interests in a joint venture, pursuant to the agreement, contract and articles of association approved by the Chinese Government.

All the activities of a joint venture shall comply with the provisions of the laws, decrees and pertinent regulations of the People's Republic of China.

Article 3.

The joint venture agreement, contract and articles of association signed by the parties to the venture shall be submitted to the Foreign Investment Commission of the People's Republic of China, and the Commission shall, within three months, decide whether to approve or disapprove them. After approval, the joint venture shall register with the General Administration for Industry and Commerce of the People's Republic of China, obtain a license to do business and start operations.

Article 4.

A joint venture shall take the form of a limited liability company.

The proportion of the investment contributed by the foreign joint venturer(s) shall generally not be less than 25 per cent of the registered capital of a joint venture.

The parties to the venture shall share the profits, risks and losses in proportion to their respective contributions to the registered capital.

No assignment of the registered capital of a joint venturer shall be made without the consent of the other parties to the venture.

Article 5.

Each party to a joint venture may make its investment in cash, in kind or in industrial property rights, etc.

The technology and the equipment that serve as a foreign joint venturer's investment must be advanced technology and equipment that actually suit our country's needs. If the foreign joint venturer causes losses by deception through the intentional use of backward technology and equipment, it shall pay compensation for the losses.

The investment of a Chinese joint venture may include the right to the use of a site provided for the joint venture during the period of its operation. If the right to the use of the site does not constitute a part of a Chinese joint venturer's investment, the joint venture shall pay the Chinese Government a fee for its use.

The various investments referred to above shall be specified in the joint venture contract and articles of association, and the value of each (excluding that of the site) shall be jointly assessed by the parties to the venture.

Article 6.

A joint venture shall have a board of directors, which shall have its size and composition stipulated in the contract and the articles of association after consultation between the parties to the venture, and the directors shall be appointed and replaced by the parties to the venture. The board of directors shall have a chairman, whose office shall be assumed by the Chinese joint venture(s), and one or two vice-chairmen, whose office(s) shall be assumed by the foreign joint venture(s). In handing major problems, the board of directors shall reach a decision through consultation by the parties to the venture, in accordance with the principle of equality and mutual benefit.

The board of directors is empowered, pursuant to the provisions of the articles of association of the joint venture, to discuss and decide all major problems of the venture: expansion programs, proposals for production and operating activities, the budget for revenues and expenditures, distribution of profits, plans concerning manpower and pay scales, the termination of business and the appointment or employment of the president, the vice-president(s), the chief engineer, the treasurer and the auditors, as well as their powers and terms of employment, etc.

The offices of president and vice-president(s) (or factory manager and deputy manager(s)) shall be assumed by the respective parties to the venture.

The employment and dismissal of the staff and workers of a joint venture shall be provided for in accordance with the law in the agreement and contract of the parties to the venture.

Article 7.

After payment out of the gross profit earned by the joint venture of the joint venture income tax, pursuant to the provisions of the tax laws of the People's Republic of China, and after deduction from the gross profit of a reserve fund, a bonus and welfare fund for staff and workers, and a venture expansion fund, as provided in the articles of association of the joint venture, the net profit shall be distributed to the parties to the joint venture in proportion to their respective contributions to the registered capital.

A joint venture that possesses advanced technology by world standards may apply for a reduction of or exemption from income tax for the first two to three profit-making years.

A foreign joint venturer that reinvests in China its share of the net profit may apply for refund of a part of the income taxes already paid.

Article 8.

A joint venture shall open an account with the Bank of China or a bank approved by the Bank of China.

The pertinent foreign exchange transactions of a joint venture shall be conducted in accordance with the regulations on foreign exchange control of the People's Republic of China.

In its operating activities a joint venture may directly raise funds from foreign banks. The various kinds of a insurance coverage of joint venture shall be furnished by Chinese insurance companies.

Article 9.

The production and operating plans of a joint venture shall be filed with the departments in charge and shall be implemented through economic contracts.

In its purchase of required raw and processed materials, fuels, parts and auxiliary equipment, etc., a joint venture should give first priority to purchases in China. It may also purchase them directly from the international market with foreign exchange raised by itself.

A joint venture is encouraged to market its products outside China. Export products may be distributed to foreign markets through the joint venture directly or through associated agencies, and they may also be distributed through China's foreign trade agencies. Products of the joint venture may also be distributed in the Chinese market.

Whenever necessary, a joint venture may establish branches outside China.

Article 10.

The net profit that a foreign joint venturer receives after fulfilling its obligations under the laws and the agreement and the contract, the funds it receives at the time of the joint venture's scheduled expiration or early termination, and its other funds may be remitted abroad through the Bank of China in accordance with the foreign exchange regulations and in the currency specified in the joint venture contract.

A foreign joint venturer shall be encouraged to deposit in the Bank of China foreign exchange that it is entitled to remit abroad.

Article 11.

The wages, salaries and other legitimate income earned by the foreign staff and workers of a joint venture, after payment of the individual income tax under the tax laws of the People's Republic of China, may be remitted abroad through the Bank of China in accordance with the foreign exchange regulations.

Article 12.

The contract period of a joint venture may be decided through consultation by the parties to the venture according to its particular line of business and circumstances. Upon the expiration of the joint venture contract period, if the parties have agreed, the period may be extended, subject to approval by the Foreign Investment Commission of the People's Republic of China. An application for extension of the contract shall be made six months before expiration of the contract.

Article 13.

Before the expiration of the joint venture contract period, in case of heavy losses, failure of a party to fulfill the obligations prescribed by the contract and the articles of association, force majeure, etc., the contract may be terminated before the date of expiration through consultation and agreement by the parties to the venture, subject to approval by the Foreign Investment Commission of the People's Republic of China and to registration with the General Administration for Industry and Commerce. In cases of losses caused by a breach of contract, the financial responsibility shall be borne by the party that has violated the contract.

Article 14.

Disputes arising between the parties to a joint venture that the board of directors cannot settle through consultation may be settled through mediation or arbitration by a Chinese arbitration agency or through arbitration by another arbitration agency agreed upon by the parties to the venture.

Article 15.

This Law shall come into force on the day of its promulgation. The power to amend this Law is vested in the National People's Congress.

(The English translations are for reference only)

Appendix 6.9

Procedures of the People's Republic of China for the Registration and Administration of Chinese-Foreign Joint Ventures

(Promulgated by the State Council on and Effective as of July 26, 1980)

Article 1.

In accordance with the provisions of the Law of the People's Republic of China on Chinese-Foreign Joint Ventures, these Procedures are formulated in order to carry out the registration and administration of Chinese-foreign joint ventures and to safeguard their lawful operations.

Article 2.

A Chinese-foreign joint venture that has been approved by the Foreign Investment Commission of the People's Republic of China shall, within one month after approval, register with the General Administration for Industry and Commerce of the People's Republic of China.

The General Administration for Industry and Commerce of the People's Republic of China shall authorise the administrative bureau for industry and commerce of the provinces, autonomous regions and municipalities directly under the central authority to handle registration procedures for Chinese-foreign joint ventures within the areas under their jurisdiction, and business license shall be issued after examination and approval by the General Administration for Industry and Commerce of the People's Republic of China.

Article 3.

A Chinese-foreign joint venture that applies for registration shall present the following documents:

(1) The document of approval issued by the Foreign Investment Commission of the People's Republic of China;

(2) Three copies each of the Chinese and foreign language texts of the joint venture agreement and contract signed by the parties to the joint venture and its articles of association; and

(3) A copy of the business license or other documents issued by the competent department of the government of the country (or region) from which the foreign joint venturer(s) come.

Article 4.

When a Chinese-foreign joint venture applies for registration, it shall fill out three copies each of a registration form in Chinese and a foreign language. The main items of registration shall be: the name of the venture, the address, the scope of production and operation, the form of production and operation, the registered capital and the proportion to be provided by each party to the joint venture, the chairman and vice-chairman of the board of directors, the president and vice-presidents or the factory manager and deputy factory managers, the number and date of the document of approval, the total number of staff and workers and the number of staff and workers of foreign nationality.

Article 5.

From the date it is issued its business license, a Chinese-foreign joint venture shall be regarded as formally established, and its legitimate production and operation activities shall be protected by the laws of the People's Republic of China.

Unregistered enterprises shall not be permitted to go into operation.

Article 6.

A Chinese-foreign joint venture shall, upon presenting its business license, open an account with the Bank of China or a bank approved by the Bank of China and register with the local tax authorities for the payment of taxes.

Article 7.

When a Chinese-foreign joint venture desires to move to a new site, change its line of production, increase, decrease of assign the registered capital or extend the contract period, it shall, within one month after approval by the Foreign Investment Commission of the People's Republic of China go through procedures for registering the changes with the administrative bureau for industry and commerce of the province, autonomous region or municipality directly under the central authority where it is located.

When there are changes in other registered items, they shall be reported in writing at the end of the year to the administrative bureau for industry and commerce of the province, autonomous region or municipality directly under the central authority where the joint venture is located.

Article 8.

When a Chinese-foreign joint venture registers or modifies its registration, it shall pay a registration fee or a fee for modification of registration, the amount of which shall be stipulated by the General Administration for Industry and Commerce of the People's Republic of China.

Article 9.

A Chinese-foreign joint venture, upon the expiration of the contract period or upon termination of the contract before the date of expiration, shall go through procedures for nullifying its registration by presenting the document of approval, issued by the Foreign Investment Commission of the People's Republic of China, to the administrative bureau for industry and commerce of the province, autonomous region or municipalities directly under the central authority where it is located and, after examination and approval by the General Administration for Industry and Commerce of the People's Republic of China, hand in its business license for cancellation.

Article 10.

The General Administration for Industry and Commerce of the People's Republic of China and the administrative bureau for industry and commerce of the provinces, autonomous regions and municipalities directly under the central authority have the right to supervise and inspect the Chinese-foreign joint ventures within the area under their jurisdiction. Violators of these Procedures shall be given a warning or a fine in accordance with the seriousness of each case.

Article 11.

These Procedures shall go into effect on the day they are promulgated.

(The English translations are for reference only)

Appendix 6.10

Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures

(Adopted at the second session of the Fifth National People's Congress on July 1, 1979, and Amended in accordance with " The decision on Amendment to The Law of the People's Republic of China on Chinese--Foreign Equity Joint Ventures" adopted at the Third Session of the Seventh National People's Congress on April 4, 1990)

Article 1 With a view to expanding international economic cooperation and technological exchange, the People's Republic of China permits foreign companies, enterprises, other economic entities or individuals (hereinafter referred to as foreign parties) to incorporate themselves, within the territory of the People's Republic of China, into equity joint ventures with Chinese companies, enterprises or other economic entities (hereinafter referred to as Chinese parties) on the principle of equality and mutual benefit and subject to authorisation by the Chinese Government.

Article 2 The Chinese Government protects, by the legislation in force, the investments of foreign parties, the profits due to them and their other lawful rights and interests in equity joint ventures, pursuant to the agreements, contracts and article of association approved by the Chinese Government.

All the activities of an equity joint venture shall be governed by the laws, decrees and pertinent rules and regulations of the People's Republic of China.

The State will not nationalise or expropriate any equity joint venture. Under special circumstances, based on the need of the social public interests, equity joint ventures may be expropriated under legal procedures and against appropriate compensation.

Article 3 All parties to an equity joint venture shall submit their agreements, contracts and articles of association to the State's Competent Department of Foreign Relations and Trade (simplified as the examination and approval authority hereinafter) for examination and approval. The examination and approval authority shall decide whether to approve or disapprove them within 3 months. Once approved, the equity joint venture shall register with the concerned department of the State Administration for Industry and Commerce, and start operation after receiving its business license.

Article 4 An equity joint venture shall take the form of a limited liability company.

In the registered capital of an equity joint venture, the proportion of the investment contributed by the foreign parties shall in general not be less than 25 percent.

The profits, risks and losses of an equity joint venture shall be shared by the parties to the venture in proportion to their contributions to the registered capital.

The transfer of one party's share in the registered capital shall be effected only with the consent of the other parties to the venture.

Article 5 Each party to an equity joint venture may contribute cash, capital goods, industrial property rights, etc. as its investment in the venture.

The technology or equipment contributed by any foreign party as investment shall be truly advanced and appropriate to China's needs. In cases of losses caused by deception through the intentional provision of outdated equipment or technology, compensation shall be paid for such losses.

The investment contributed by a Chinese party may include the right to the use of a site provided for the equity joint venture during the period of its operation. In case such a contribution does not constitute a part of the investment from the Chinese party, the venture shall pay the Chinese Government a fee for its use.

The various contributions referred to in the present Article shall be specified in the contracts concerning the equity joint venture or in its articles of association, and the value of each contribution (excluding that of the site) shall be ascertained by the parties to the venture through joint assessment.

Article 6 An equity joint venture shall have a board of directors with a composition stipulated in the contract and the articles of association after consultation between the parties to the venture; each director shall be appointed and replaced by his own side. The chairman and the vice-chairmen shall be chosen through consultation by the parties to the venture or elected by the board of directors. If the Chinese side or the foreign side assumes the office of the chairman, the other side shall assume the office (s) of the vice- chairman or vice-chairmen. The board of directors shall decide on important problems concerning the equity joint venture on the principle of equality and mutual benefit.

The board of directors is empowered to discuss and take action on, pursuant to the provisions of the articles of association of the equity joint venture, all fundamental issues concerning the venture, namely, expansion projects, production and business programmes, the budget, distribution of profits, plans concerning manpower and pay scales, the termination of business, the appointment or hiring of the president, the vice-president (s), the chief engineer, the treasurer and the auditors as well as their functions and powers and their remuneration, etc.

The president and vice-president (s) (or the general manager and assistant general manager (s) in a factory) shall be chosen from the various parties to the equity joint venture.

Procedures concerning the employment and discharge of the workers and staff members of an equity joint venture shall be stipulated according to law in the agreement or contract concluded between the parties to the venture.

Article 7 The net profits of an equity joint venture shall be distributed among the parties to the venture in proportion to their respective shares in the registered capital after the payment of an equity joint venture income tax on its gross profit pursuant to the tax laws of the people's Republic of China and after the deductions therefrom as stipulated in the articles of association of the venture for the serve funds, the bonus and welfare funds for the workers and staff members and the expansion funds of the venture.

An equity joint venture may, in accordance with provisions of the relevant laws and administrative rules and regulations of the State on taxation, enjoy preferential treatment for reduction of, or exemption from taxes.

A foreign party who re-invests any part of his share of the net profit within Chinese territory may apply for the restitution of a part of the income taxes paid.

Article 8 An equity joint venture shall, on the strength of its business licence, open a foreign exchange account with a bank or and other financial institution which is permitted by the State agency for foreign exchange control to handle foreign exchange transactions.

An equity joint venture shall conduct its foreign exchange transactions in accordance with the Foreign Exchange Regulations of the People's Republic of China.

An equity joint venture may, in its business operations, obtain funds from foreign banks directly.

The insurance appropriate to a joint venture shall be furnished by Chinese insurance companies.

Article 9 The production and business programmes of an equity joint venture shall be filed with the authorities concerned and shall be implemented through business contracts.

In its purchase of required raw and semi-processed materials, fuels, auxiliary equipment, etc. , an equity joint venture shall give first priority to Chinese sources, but may also acquire them directly from the international market with its own foreign exchange funds.

An equity joint venture is encouraged to market its products outside China. It may distribute its export products on foreign markets through direct channels or its associated agencies or China's foreign trade establishments. Its products may also be distributed on the Chinese market.

Whenever necessary, an equity joint venture may set up affiliated agencies outside China.

Article 10 The net profit which a foreign party receives as his share after performing his obligations under the pertinent laws and agreements and contracts, the funds he receives at the time when the equity joint venture terminates or winds up its operations and his other funds may be remitted abroad in accordance with the foreign exchange regulations and in the currency (.ies) specified in the contracts concerning the ventures.

A foreign party is encouraged to deposit in the Bank of China any part of foreign exchange which he is entitled to remit abroad.

Article 11 The wages, salaries or other legitimate income of the foreign employees of an equity joint venture, after payment of the personal income tax under the tax laws of the People's Republic of China, may be remitted abroad in accordance with the foreign exchange regulations.

Article 12 The operation periods of equity joint ventures may be handled differently according to their particular lines of business and circumstances. Equity joint ventures engaged in a certain line of business shall specify in the contracts their operation periods, while equity joint ventures engaged in another line of business may choose whether or not to specify their operation periods. In the case of an equity joint venture with its operation period specified, if the parties to the venture agree to extend the operation period, the venture may send an application to the examining and approval authority 6 months before the expiration of the operation period. The examination and approval authority shall, within 1 month of receipt of the application, decide whether to approve or disapprove it.

Article 13 If there occur heavy losses, the failure of a party to perform its obligations under the contract and the articles of association or force majeure, etc., the equity joint venture may terminate the contract through consultation and agreement by the parties, and subject to approval by the examination and approval authority and to registration with the State's Competent Department of Industry and Commerce Administration. In cases of losses caused by a breach of contract, the financial responsibility shall be borne by the party that has breached the contract.

Article 14 Disputes arising between the parties to an equity joint venture which the board of directors fails to settle through consultation may be settled through conciliation or arbitration by an arbitral body of China or through arbitration by an arbitral body agreed upon by the parties.

Article 15 The present law comes into force as of the date of its promulgation. The right to amendment is vested in the National People's Congress.

Appendix 6.11

Interim Provisions for the Duration of Chinese-Foreign Equity Joint Ventures

(Approved by the State Council on September 30, 1990 and promulgated by the Ministry of Foreign Economic Relations and Trade on October 22, 1990)

Article 1 These Provisions are formulated in accordance with the Article 12 of the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (amended by the Third Session of the Seventh National People's Congress on April 4, 1990).

Article 2 The parties to a Chinese-foreign equity joint venture (hereinafter referred to as a "joint venture") may or may not stipulate the duration in the contract of the joint venture which falls within the category of the investment projects encouraged and permitted by the State, unless the Article 3 of these Provisions otherwise stipulates.

Article 3 The parties to a joint venture shall specify the duration in the contract of the joint venture in accordance with the relevant laws and regulations of the State provided that the joint venture is engaged in any of the following lines of trade or operates in the following circumstances:

(1) Service trades, such as hotel, apartment or office buildings, entertainment, catering, taxi, colour developing and printing, maintenance, consultations;

(2) Land development, and operation and management of real estate;

(3) Exploration and exploitation of resources;

(4) Investment projects restricted by the State;

(5) Others for which the duration is required to be included in the contract by the laws or regulations of the State.

Article 4 A joint venture contract in which the parties do not specify the duration shall be examined and approved pursuant to the authorisation and procedures of examination and approval stipulated by the State. And the examination and approval authorities shall report this to the Ministry of Foreign Economic Relations and Trade for the record within 30 days after the approval is granted except for those approved by the Ministry of Foreign Economic Relations and Trade itself.

Article 5 A joint venture to which the parties do not provide the duration in the joint venture contract may, subject to the approval of a taxation authority, enjoy the preferential treatment of tax reduction or exemption according to the tax laws of the State. If the actual operation period of such joint venture is shorter than the time limit for enjoying the preferential treatment of tax set by the State, the joint venture, according to law, shall make up for the amount of tax which has been reduced or exempted already.

Article 6 A joint venture approved and established before the implementation of these Provisions may continue its operation under the provisions of duration in the approved contract. Except for the joint ventures stipulated in Article 3 of these Provisions, such joint venture may alter its fixed duration to non-duration agreed upon by the parties and the parties shall conclude the amendment to the joint venture contract and make an application with reasons to the original examination and approval authority for examination.

The original examination and approval authority shall decide to grant an approval or disapproval of the alteration within 90 days after the receipt of the above mentioned relevant documents. Upon approval, the joint venture shall go through the procedures of filing according to Article 4 of these Provisions.

Article 7 These Provisions shall be implemented from the date of its promulgation.

Appendix 6.12

Law of the People's Republic of China on Chinese- Foreign Contractual Joint Ventures

(Adopted at the First Session of the Seventh National People's Congress and promulgated by Order No.4 of the President of the People's Republic of China on April 13, 1988, and effective as of the date of promulgation)

Article 1 This Law is formulated to expand economic cooperation and technological exchange with foreign countries and to promote the joint establishment, on the principle of equality and mutual benefit, by foreign enterprises and other economic organisations or individuals (hereinafter referred to as the foreign party) and Chinese enterprises or other economic organisations (hereinafter referred to as the Chinese party) of Chinese-foreign contractual joint ventures (hereinafter referred to as contractual joint ventures) within the territory of the People's Republic of China.

Article 2 In establishing a contractual joint venture, the Chinese and foreign parties shall, in accordance with the provisions of this Law, prescribe in their contractual joint venture contract such matters as the investment or conditions for cooperation, the distribution of earnings or products, the sharing of risks and losses, the manners of operation and management and the ownership of the property at the time of the termination of the contractual joint venture.

A contractual joint venture which meets the conditions for being considered a legal person under Chinese law, shall acquire the status of a Chinese legal person in accordance with law.

Article 3 The State shall, according to law, protect the lawful rights and interests of the contractual joint ventures and of the Chinese and foreign parties.

A contractual joint venture must abide by Chinese laws and regulations and must not injure the public interests of China.

The relevant State authorities shall exercise supervision over the contractual joint ventures according to law.

Article 4 The State shall encourage the establishment of productive contractual joint ventures that are export-oriented or technologically advanced.

Article 5 For the purpose of applying for the establishment of a contractual joint venture, such documents as the agreement, the contract and the articles of association signed by the Chinese and foreign parties shall be submitted for examination and approval to the department in charge of foreign economic relations and trade under the State Council or to the department or local government authorised by the State Council (hereinafter referred to as the examination and approval authority). The examination and approval authority shall, within 45 days of receiving the application, decide whether or not to grant approval.

Article 6 When the application for the establishment of a contractual joint venture is approved, the parties shall, within 30 days of receiving the certificate of approval, apply to the administrative authorities for industry and commerce for registration and obtain a business license. The date of issuance of the business license of a contractual joint venture shall be the date of its establishment.

A contractual joint venture shall, within 30 days of its establishment, carry out tax registration with the tax authorities.

Article 7 If the Chinese and foreign parties, during the period of operation of their contractual joint venture, agree through consultation to make major modifications to the contractual joint venture contract, they shall report to the examination and approval authority for approval, if the modifications include items involving statutory industry and commerce registration or tax registration, they shall register the modifications with the administrative authorities for industry and commerce and with the tax authorities.

Article 8 The investment or conditions for cooperation contributed by the Chinese and foreign parties may be provided in cash or in kind, or may include the right to the use of land, industrial property rights, non-patent technology or other property rights.

Article 9 The Chinese and foreign parties shall, in accordance with the provisions of the laws and regulations and the agreements in the contractual joint venture contract, duly fulfil their obligations of contributing full investment and providing the conditions for cooperation. In case of failure to do so within the prescribed time, the administrative authorities for industry and commerce shall set another time limit for the fulfilment of such obligations; if such obligations are still not fulfilled by the new time limit, the matter shall be handled by the examination and approval authority and the administrative authorities for industry and commerce according to relevant state provisions.

The investments or conditions for cooperation provided by the Chinese and foreign parties shall be verified by an accountant registered in China or the relevant authorities, who shall provide a certificate after verification.

Article 10 If a Chinese or foreign party wishes to make an assignment of all or part of its rights and obligations prescribed in the contractual joint venture contract, it must obtain the consent of the other party or parties and report to the examination and approval authority for approval.

Article 11 A contractual joint venture shall conduct its operational and managerial activities in accordance with the approved contract and articles of association for the contractual joint venture. The right of a contractual joint venture to make its own operational and managerial decisions shall not be interfered with.

Article 12 A contractual joint venture shall establish a board of directors or a joint managerial institution which shall, according to the contract or the articles of association for the contractual joint venture, decide on the major issues concerning the venture. If the Chinese or foreign party assumes the chairmanship of the board of directors or the directorship of the joint managerial institution, the other party shall assume the vice-chairmanship of the board or the deputy directorship of the joint managerial institution. The board of directors or the joint managerial institution may decide on the appointment or employment of a general manager, who shall take charge of the daily operation and management of the contractual joint venture. The general manager shall be accountable to the board of directors or the joint managerial institution.

If a contractual joint venture, after its establishment, chooses to entrust a third party with its operation and management, it must obtain the unanimous consent of the board of directors or the joint managerial institution, report to the examination and approval authority for approval, and register the change with the administrative authorities for industry and commerce.

Article 13 The employment, dismissal, remuneration, welfare, labour protection and labour insurance, etc. of the staff members and workers of a contractual joint venture shall be specified in contracts concluded in accordance with law.

Article 14 The staff and workers of a contractual joint venture shall, in accordance with law, establish their trade union organisation to carry out trade union activities and protect their lawful rights and interests.

A contractual joint venture shall provide the necessary conditions for the venture's trade union to carry out its activities.

Article 15 A contractual joint venture must establish its account books within the territory of China, file its accounting statements according to relevant provisions and accept supervision by the financial and tax authorities.

If a contractual joint venture, in violation of the provisions prescribed in the preceding paragraph, does not establish its account books within the territory of China, the financial and tax authorities may impose a fine on it, and the administrative authorities for industry and commerce may order it to suspend its business operations or may revoke its business license.

Article 16 A contractual joint venture shall, by presenting its business license, open a foreign exchange account with a bank or any other financial institution which is permitted by the exchange control authorities of the State to conduct transactions in foreign exchange. A contractual joint venture shall handle its foreign exchange transactions in accordance with the provisions of the State on foreign exchange control.

Article 17 A contractual joint venture may obtain loans from financial institutions within the territory of China and may also obtain loans outside the territory of China. Loans to be used by the Chinese and foreign parties as investment or conditions for cooperation, and their guarantees, shall be provided by each party on its own.

Article 18 The various kinds of insurance coverage of a contractual joint venture shall be furnished by insurance institutions within the territory of China.

Article 19 A contractual joint venture may, within its approved scope of operation, import materials it needs and export products it produces. A contractual joint venture may purchase, on both the domestic market and the world market, the raw and processed materials, fuels, etc. within its approved scope of operation.

Article 20 A contractual joint venture shall achieve on its own the balance of its foreign exchange receipts and expenditures. If a contractual joint venture is unable to achieve the balance of its foreign exchange receipts and expenditures on its own, it may, in accordance with State provisions, apply to the relevant authorities for assistance.

Article 21 A contractual joint venture shall, in accordance with State provisions on tax, pay taxes and may enjoy the preferential treatment of tax reduction or exemption.

Article 22 The Chinese and foreign parties shall share earnings or products, undertake risks and losses in accordance with the agreements prescribed in the contractual joint venture contract.

If, upon the expiration of the period of a venture's operation, all the fixed assets of the contractual joint venture, as agreed upon by the Chinese and foreign parties in the contractual joint venture contract, are to belong to the Chinese party, the Chinese and foreign parties may prescribe in the contractual joint venture contract the ways for the foreign party to recover its investment ahead of time during the period of the venture's operation. If the foreign party, as agreed upon in the contractual joint venture contract, is to recover its investment prior to the payment of income tax, it must apply to the financial and tax authorities, which shall examine and approve the application in accordance with State provisions concerning taxes.

If, according to the provisions of the preceding paragraph, the foreign party is to recover its investment ahead of time during the period of the venture's operation, the Chinese and foreign parties shall, as stipulated by the relevant laws and agreed in the contractual joint venture contract, be liable for the debts of the venture.

Article 23 After the foreign party has fulfilled its obligations under the law and the contractual joint venture contract, the profits it receives as its share, its other legitimate income and the funds it receives as its share upon the termination of the venture, may be remitted abroad according to law.

The wages, salaries or other legitimate income earned by the foreign staff and workers of contractual joint ventures, after the payment of the individual income tax according to law, may be remitted abroad.

Article 24 Upon the expiration or termination in advance of the term of a contractual joint venture, its assets, claims and debts shall be liquidated according to legal procedures. The Chinese and foreign parties shall, in accordance with the agreement specified in the contractual joint venture contract, determine the ownership of the venture's property.

A contractual joint venture shall, upon the expiration or termination in advance of its term, cancel its registration with the administrative authorities for industry and commerce and the tax authorities.

Article 25 The period of operation of a contractual joint venture shall be determined through consultation by the Chinese and foreign parties and shall be clearly specified in the contractual joint venture contract. If the Chinese and foreign parties agree to extend the period of operation, they shall apply to the examination and approval authority 180 days prior to the expiration of the venture's term. The examination and approval authority shall decide whether or not to grant approval within 30 days of receiving the application.

Article 26 Any dispute between the Chinese and foreign parties arising from the execution of the contract or the articles of the association for a contractual joint venture shall be settled through consultation or mediation. In case of a dispute which the Chinese or the foreign party is unwilling to settle through consultation or mediation, or of a dispute which they have failed to settle through consultation or mediation, the Chinese and foreign parties may submit it to a Chinese arbitration agency or any other arbitration agency for arbitration in accordance with the arbitration clause in the contractual joint venture contract or written agreement on arbitration concluded afterwards.

The Chinese or foreign party may bring a suit in a Chinese court, if no arbitration clause is provided in the contractual joint venture contract and if no written agreement is concluded afterwards.

Article 27 The detailed rules for the implementation of this Law shall be formulated by the department in charge of foreign economic relations and trade under the State Council and reported to the State Council for approval before implementation.

Article 28 This Law shall come into force as of the date of its promulgation.

Appendix 6.13

Detailed Rules for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures

(Approved by the State Council of the People's Republic of China on August 7, 1995 and Promulgated by the Ministry of Foreign Trade and Economic Cooperation on September 4, 1995)

Chapter I General Provisions

Article 1 These Detailed Rules are formulated in accordance with the Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures.

Article 2 The establishment of Chinese-Foreign cooperative joint ventures (hereinafter referred to as cooperative joint ventures) in the territory of China shall comply with the development policy and industrial policy of the State, and the provisions of the State for the guidance of foreign investment direction.

Article 3 A cooperative joint venture may, within the perimeters of the approved cooperative joint venture agreement, contract and articles of association, conduct business and management activities independently according to law and free from the intervention of any organisation or individual.

Article 4 A cooperative joint venture may be either a joint venture with the status of a Chinese legal person obtained according to law or one without the legal person status.

For a cooperative joint venture without the legal person status, where Chapter IX of the Detailed Rules has special provisions, these provisions shall apply.

Article 5 The competent authority for a cooperative joint venture shall be the competent authority for the Chinese party of the joint venture. Where there are more than one Chinese party to the cooperative joint venture, the examination and approval authority shall decide on a competent authority for the cooperative joint venture in consultation with relevant departments, unless otherwise stipulated in laws and administrative rules.

The competent authority for a cooperative joint venture shall conduct coordination and afford assistance in relation to matters of the cooperative joint venture.

Chapter II The Establishment of a Cooperative Joint Venture

Article 6 The establishment of a cooperative joint venture shall be examined and approved by the Ministry of Foreign Trade and Economic Cooperation or the department and local people's government authorised by the State Council.

The department or local people's government authorised by the State Council may examine and approve cooperative joint ventures in the following circumstances:

(1) The total amount of investment is within the authorisation for approval as set by the State Council, by the departments or local people's governments authorised by the State Council;

(2) The capital has been raised by the applicants themselves, construction and production conditions do not need to be balanced by the State;

(3) Exportation of the products of the cooperative joint venture does not require export quota and license to be issued by relevant competent departments of the State; or if exportation requires quota and license, the consent of relevant competent departments has been obtained prior to submitting the application for establishing the cooperative joint venture.

(4) Other circumstances in which the departments or local governments authorised by the State Council may examine and approve cooperative joint ventures as stipulated in laws and administrative rules.

Article 7 To establish a cooperative joint venture, the Chinese party/parties (hereinafter referred to as the Chinese party) shall submit to the examination and approval authority the following documents:

(1) Application for establishing a cooperative joint venture accompanied by the examination and approval documents of the competent authority;

(2) Feasibility study report jointly prepared by all parties to the cooperative joint venture accompanied by the examination and approval documents of the competent authority;

(3) Joint venture agreement, contract and articles of association signed by the legal representatives or representatives authorised by them of all parties to the joint venture;

(4) Business licenses or registration certificates, financial credit documents and valid certification documents of the legal representatives of all parties to the joint venture; where the foreign party/parties (hereinafter referred to as the foreign party) is a natural person, valid certification documents on his/her identity, resume and financial credit shall be presented;

(5) List of chairman, deputy chairmen and members of the board of directors or list of director, deputy directors and members of the joint management committee of the cooperative joint venture as determined by all parties through consultation;

(6) Other documents as required by the examination and approval authority.

The documents listed in the preceding paragraph shall be written in Chinese with the exception of the documents in the subparagraph (4) to be presented by the foreign party, each of the documents required under subparagraph (2), (3) and (5) may be accompanied by a version of a foreign language agreed upon by all parties.

The examination and approval authority shall decide whether to approve or disapprove the application for the establishment of a cooperative joint venture within 45 days from the date of receiving all the documents as stipulated; should anything incomplete or inappropriate be found in the documents presented, the examination and approval authority may demand a supplement or amendment to them within a limited period of time.

Article 8 For a cooperative joint venture approved by the Ministry of Foreign Trade and Economic Cooperation or by departments authorised by the State Council, the certificate of approval shall be granted by the Ministry of Foreign Trade and Economic Cooperation.

For a cooperative joint venture approved by local people's government authorised by the State Council, the relevant local people's government shall grant the certificate of approval and submit the relevant approval documents to the Ministry of Foreign Trade and Economic Cooperation for recordation within 30 days from the date of approval.

The cooperative joint venture approved for establishment shall apply, according to law, to the administrative authorities for industry and commerce for registration and business license.

Article 9 An application for establishing a cooperative joint venture shall not be approved if the venture involves in any of the following circumstances:

(1) Detriment to China's sovereignty or public interest;

(2) Jeopardising the State security;

(3) Polluting and damaging the environment;

(4) Other circumstance involving violation of laws, administrative rules and the State industrial policies.

Article 10 For the purpose of the Detailed Rules, the cooperative joint venture agreement refers to a written document produced after all parties reached consensus on the principles and significant matters in relation to the establishment of the cooperative joint venture.

For the purpose of the Detailed Rules, the cooperative joint venture contract refers to a written document produced after all parties reached consensus on their respective rights and obligations in the cooperative joint venture.

For the purpose of the Detailed Rules, the articles of association of a cooperative joint venture refers to a written document laying down the principles of organisation and method of operation and management as agreed on by all parties in line with the cooperative joint venture contract.

Where there are any contents in the agreement and articles of association which are inconsistent with the contract of a cooperative joint venture, the contract shall prevail.

The parties to a cooperative joint venture may not sign a cooperative joint venture agreement.

Article 11 The agreement, contract and articles of association of a cooperative joint venture shall enter into force upon the issuance of the certificate of approval by the examination and approval authority. For the duration of the cooperative joint venture, and substantive amendment to the agreement, contract and article of association of the cooperative joint venture shall be approved by the examination and approval authority.

Article 12 The contract of a cooperative joint venture shall bear the following items:

(1) Names, place of registration, domicile of all parties, and names, titles and nationalities of their legal representatives (where the foreign party is a natural person, his/her name, nationality and domicile);

(2) Name, address and business scope of the cooperative joint venture;

(3) Total amount of investment, registered capital, way and duration of investment or cooperation conditions contributed by each party;

(4) Transfer of investment contribution or provision of cooperation conditions by each party;

(5) Distribution of income or products to all parties, apportioning of risk or loss between the parties;

(6) Composition of the board of directors or the joint management committee, allocation of the members of the board of directors or the joint management committee, responsibilities of and the ways for employment and dismissal of the president and other senior management people;

(7) Main production equipment and production technology to be employed, and their sources;

(8) Arrangement for sales of products in and outside China;

(9) Arrangement for the income and expenditure of foreign exchanges of the cooperative joint venture;

(10) duration, dissolution and liquidation of the cooperative joint venture;

(11) Other obligations of the parties and the responsibilities arising from breach of the contract;

(12) Principles for handling finance, accounting and auditing;

(13) Settlement between and among all parties;

(14) Procedures for amending the cooperative joint venture contract.

Article 13 The articles of association of a cooperative joint venture shall include the following items:

(1) Name and address of the cooperative joint venture;

(2) Business scope and duration of cooperation of the cooperative joint venture;

(3) Names, places of registration, domicile of all parties to the cooperative joint venture and names, titles, and nationalities of their legal representatives (where the foreign party is a natural person, his/her name, nationality and domicile);

(4) Total amount of investment, registered capital, ways and duration of investment or cooperation conditions contributed by the parties to the cooperative joint venture;

(5) Distribution of income or products to all parties and apportioning of risk and loss between the parties;

(6) Composition, terms of reference and proceedings of the board of directors or joint management committee of the cooperative joint venture; term of office for directors of the board of directors or members on the joint management committee; terms of reference of chairman and vice chairmen of the board of directors or director and deputy directors of the joint management committee;

(7) Establishment, terms of reference and rules for handling matters of the operation and management body; terms of reference, engagement and dismissal of general manager and other senior management personnel;

(8) Regulations related to labour management covering employment of staff and workers, training, labour contract, salaries & wages, social insurance, welfare benefits, job safety, etc.;

(9) Finance, accounting and auditing system of the cooperative joint venture;

(10) Dissolution and liquidation of the cooperation joint venture;

(11) Procedures for amendment of the articles of association of the cooperative joint venture.

Chapter III Form of Organisation and Registered Capital

Article 14 The cooperative joint venture, after obtaining the status of Chinese legal person, shall take the form of a limited liability company. Unless otherwise stipulated in the cooperative joint venture contract, each party shall be held liable to the cooperative joint venture within the limit of its investment and cooperation conditions contributed to the cooperative joint venture.

The cooperative joint venture shall be held liable to its debts within the limit of its total assets.

Article 15 The total amount of investment of a cooperative joint venture refers to the sum of funds necessary for reaching the production scale provided for by the cooperative joint venture contract and the articles of association of the cooperative joint venture.

Article 16 The registered capital of a cooperative joint venture refers to the total amount of capital, contributed by all parties to the cooperative joint venture and registered with the authority for industry and commerce when applying for the establishment of the cooperative joint venture. Registered capital can be either denominated in Renminbi Yuan or in any other freely convertible foreign currency as agreed upon by all parties to the cooperative joint venture.

Any decrease in the registered capital of the cooperative joint venture is not allowed during the term of cooperation. However, any decrease, necessary due to changes in the total amount of investment and production scale, shall be subject to the approval of the examination and approval authority.

Chapter IV Investment and Cooperation Conditions

Article 17 All parties to cooperative joint venture shall, in accordance with the provisions of relevant laws and administrative regulations and stipulations of the cooperative joint venture contract, make their investment or provide cooperation conditions to the cooperative joint venture.

Article 18 The investment made or cooperation conditions provided by all parties to the cooperative joint venture may be in cash, in kind, or in other property rights such as industrial property rights, know-how and land-use rights.

Where the investment or cooperation conditions provided by the Chinese party fall into the category of State assets, an asset evaluation shall be conducted in accordance with relevant provisions of laws and administrative regulations.

For a cooperative joint venture which has obtained the status of a Chinese legal person according to law, the investment made by the foreign party shall be, in general, no less that 25% of the registered capital of the venture. For a cooperative joint venture without the status of a legal person, the specific requirements for the investment made and cooperation conditions contributed by all parties to the venture shall be subject to the regulations stipulated by the Ministry of Foreign Trade & Economic Cooperation.

Article 19 The investment made or cooperation conditions provided shall be the property or property rights owned by the parties to a cooperative joint venture. The investment made or cooperation conditions provided shall not be property or property rights already posted as mortgage or other forms of collaterals.

Article 20 All parties to a cooperative joint venture shall stipulate, based on the production and operation requirements of the venture and in light of the provisions of relevant laws and administrative regulations, the duration of the investment to be made and the cooperation conditions to be contributed in the joint venture contract.

In the event of a failure to make the investment or provide the cooperative conditions as set forth by the cooperative joint venture contract, the authority for the administration of industry & commerce shall specify a time limit for performance. If the said obligations are still not performed upon the expiration of the specified time limit, the examination and approval authority shall revoke the certificate of approval and the authority for the administration of industry and commerce shall revoke the business license of the cooperative joint venture and make a public announcement to that effect.

Article 21 The party failing to make investment or provide cooperation conditions as set forth by the cooperative joint venture contract shall be held liable for the breach of contract to the other party which have performed their duties as stipulated in the contract.

Article 22 The investments made or cooperation conditions contributed by all parties to the cooperative joint venture shall be verified by, and reports of verification shall be submitted by accountants registered in China. And certificates of contribution shall be issued thereupon to all parties by the cooperative joint venture. The certificate of contribution shall include the following items:

(1) Name of the cooperative join venture;

(2) Date of the establishment of the cooperative joint venture;

(3) Names of all parties to the cooperative joint venture;

(4) Contents of the investments made or the cooperation conditions contributed by all parties to the cooperative joint venture;

(5) Date of contribution of investments or provision of operation conditions by all parties to a cooperative joint venture;

(6) Serial No. and date of issuance of the certificate of contribution.

Copies of the certificate of contribution shall be submitted respectively to the examination and approval authority and the authority for the administration of industry and commerce.

Article 23 Mutual transfer of all or part of its rights under the cooperative joint venture contract between parties to the venture or transfer of all or part of its rights under the contract from one party to a third party other than the parties to the venture shall be subject to the consent in written form from the other party, and the matter shall be submitted to the examination and approval authority for approval.

The examination and approval authority shall decide to approve or disapprove the assignment within 30 days of receipt of the relevant documents.

Chapter V Organisational Structure

Article 24 A board of directors or a joint management committee shall be established in a cooperative joint venture. The board of directors or the joint management committee shall be the power organ of the cooperative joint venture, and shall, in accordance with the provisions of the articles of association of the cooperative joint venture, decide on major important issues concerning the cooperative joint venture.

Article 25 The board of directors or the joint management committee shall consist of at least three persons. The allocation of members shall, through consultations between the Chinese party and the foreign party, be decided with reference to the proportion of the investments or cooperation conditions contributed by each party.

Article 26 Directors of the board of directors or members on the joint management committee shall be appointed or replaced by all parties themselves. The selection of chairman and vice chairmen of the board of directors or director and. deputy directors of the joint management committee shall be provided for in the articles of association of the cooperative joint venture. Where the position of chairman of the board of directors or director of the joint management committee is assumed by a nominee of the Chinese party or the foreign party, the position/positions of vice chairman/chairmen or deputy director/directors shall be assumed by a nominee of the other party.

Article 27 The tenure of directors and members on the joint management committee shall be decided by articles of association of the cooperative joint venture, with each tenure no longer that three years. Upon expiration of each tenure, directors and members may renew their tenure if reappointed by the appointing party.

Article 28 Directors of the board or members on the joint management committee shall meet at least once a year, with the meeting convened and presided over by the chairman of the board or director of the committee. Where the chairman of the board or the director of the committee is unable to perform his/her duties out of special reasons, he/she may appoint a vice chairman of the board, deputy director of the committee, other directors or members to convene and preside over such meetings. Meetings of the board or committee may be convened on proposals made by more that one third of the total number of directors or members. Meetings of the board or committee can only be convened with the presence of more than two thirds of directors or members. Directors or members unable to participate in such meetings shall entrust, in written form, others to participate in such meetings and lodge votes on their behalf. Decisions made at the board or the committee meetings shall be adopted with the consents of more than half of the directors or members. Directors or members who neither participate in the said meetings nor entrust others to participate in the said meetings on their behalf without any reasonable excuse shall be regarded as having participated in the meetings of the board or the committee and having lodged abstention votes.

All directors or members shall be notified of the board or the committee meetings 10 days prior to their convocation.

Decisions may also be made by the board or the committee through correspondence.

Article 29 Decisions concerning the following items can only be adopted with the unanimous consent of all the directors or members participating in the meetings of the board or the committee:

(1) Amendment to the articles of association of the cooperative joint venture;

(2) Increase or reduction of the registered capital of the cooperative joint venture;

(3) Dissolution of the cooperative joint venture;

(4) Mortgage of the assets of the cooperative joint venture;

(5) Merge and split of the cooperative joint venture and change in the form of the organisation;

(6) Other matters which may only be decided with unanimous consent at the meetings of the board or the committee as previously agreed upon by parties to the joint venture.

Article 30 Decision-making process and voting procedures of the board of directors and the joint management committee, other than those being stipulated in these Detailed Rules, shall be provided for in the articles of association of the cooperative joint venture.

Article 31 The chairman of the board or the director of the committee is the legal person of the cooperative joint venture. Where the chairman of the board or the director of the committee is unable to perform his duty out of special reasons, vice chairman of the board, deputy director of the committee, other directors or members shall be authorised to represent the cooperative joint venture in its external relations.

Article 32 A cooperative joint venture shall have one general manager who will be responsible for the routine operation and management of the joint venture and accountable to the board of directors or the joint management committee.

The general manager of a cooperative joint venture shall be engaged or dismissed by the board of directors or the joint management committee.

Article 33 Posts of the general manager and other senior managers may be assumed by Chinese or foreign citizens.

Directors of members may assume concurrently the posts of the general manager or other senior manages of the cooperative joint venture, as engaged by the board of directors or the joint management committee.

Article 34 The general manager or other senior managers who are incompetent or found to have actions of malpractices or serious negligence of duty may be dismissed as decided by the board of directors or the joint management committee, and those who cause losses to the cooperative joint venture shall be held responsible in accordance with relevant laws and regulations.

Article 35 Where a party other than the parties to a cooperative joint venture is entrusted with the business operation and management of the venture after its establishment, unanimous consent of the board of directors or the joint management committee shall be obtained and a contract of trusteeship for operation and management shall be entered into with the trustee.

The cooperative joint venture shall submit documents such as the resolution of the board of directors or the joint management committee, the contract of trusteeship that has been signed and the financial credit documents of the trustee, etc. to the examination and approval authority for approval. The examination and approval authority shall thereupon decide to approve or disapprove within 30 days upon receipt of the said documents.

Chapter VI Purchase of Materials and Marketing of Products

Article 36 The cooperative joint venture shall work out production and operation plans on its own, based on the approved business scope and scale of production and operation.

Governmental organisations shall not a force cooperative joint venture to carry out production and operation plans formulated by governmental organisations.

Article 37 a cooperative joint venture may decide, on its own, to purchase either within the territory of China or from foreign countries machines and equipment, raw materials, fuels, parts and components, accessories, transportation tools and office articles, etc. (hereinafter referred to as "materials").

Article 38 The State encourages cooperative joint ventures to sell their products on international markets. These ventures may directly sell their products on international markets or entrust overseas distributors or Chinese Foreign trade companies to sell their products by proxy or on commission.

Prices of the products sold by the cooperative joint venture shall be decided by the venture itself according to law.

Article 39 Machines and equipments, parts and components as well as other materials imported by the foreign party as investment in kind and machines and equipments, parts and components and other materials needed in production and operation, which are imported by the cooperative joint venture with funds of the total investment are exempt from import tariffs and turnover tax in the import links. When the above-mentioned imported materials which are exempt from tariffs and tax are resold within the territory of China or put into domestic commercial channel upon approval, tariffs and tax or overdue tariffs or tax shall be paid in accordance with relevant laws and regulations.

Article 40 A cooperative joint venture shall not export products at prices ostensibly lower than reasonable prices of products of the like on international markets or import materials at prices higher than those of products of the like on the international markets.

Article 41 Products of a cooperative joint venture shall be sold in compliance with the provisions of the approved contract of the venture.

Article 42 The cooperative joint venture shall apply, in accordance with relevant State regulations, for import or export licenses and quotas for products subject to licensing and quota administration which they intend to import or export.

Chapter VII Distribution of Income and Recovery of Investment

Article 43 Chinese and Foreign parties to a cooperative joint venture may distribute income through profit-sharing or other forms as agreed upon by both parties.

Tax payable shall be calculated according to relevant provisions of the tax law when product-sharing or other forms are adopted in income distribution.

Article 44 On the expiration of the cooperation as defined in the contracts of the cooperative joint ventures by Chinese and foreign parties, all the fixed assets of the ventures shall belong to the Chinese party on a gratuitous basis and the Foreign party may apply, within the term of the cooperation, for an early recovery of their investment in the following ways:

(1) On the basis of distribution according to the contribution of investment or cooperation conditions, agreement shall be reached in the contract of the cooperative joint venture to increase the proportion of profit sharing to the Foreign party;

(2) Upon examination and approval by the finance and taxation authorities according to State provisions on taxation, the Foreign party may first recover its investment before income tax payment is made by the cooperative joint venture;

(3) Other means of investment recovery approved by the finance and taxation authorities as well as the examination and approval authority. For a cooperative joint venture that allows the Foreign party to first recover the investment, as defined in the preceding paragraph, the Chinese and Foreign parties shall share the liabilities of the cooperative joint venture in light of relevant legal provisions and agreements in the joint venture contract.

Article 45 When the foreign party of the venture applies for an early recovery of investment according to Article 44 (1) and (2), the party shall specifically explain the amount of the investment and the time and ways it would like to first recover such investment. Upon approval by the finance and taxation authorities after examination, such application shall be submitted to the examination and approval authority for final review and approval.

The Foreign party shall not be allowed to recover its investment unless the losses of the cooperative joint venture is recovered.

Article 46 A cooperative joint venture shall entrust, according to relevant State provisions, accountants registered in China to check and verify the account-books. Parties to the cooperative joint venture may either jointly or separately entrust accountants registed in China to check the account-books, and costs incurred therefrom shall be born by the party (or parties) that entrust the accountants.

Chapter VIII Duration and Dissolution

Article 47 The duration of a cooperative joint venture shall be decided upon by all parties to the joint venture through consultation and shall be stipulated in the joint venture contract.

If extension of the term of cooperation is agreed upon by all parties upon expiration of the duration of the cooperative joint venture, an application shall be submitted 180 days before the expiration to the examination and approval authority, with due explanations on the execution of the contract establishing the cooperative joint venture, reason for the extension, and agreement on rights and obligations and other matters of each party in the extended period. The examination and approval authority shall decide to approve or disapprove within 30 days upon receipt of the extension application.

Upon approval of the extension of duration, the cooperative joint venture shall go through formalities for the alteration of registration with the administrative authority for industry and commerce, and the extended duration shall start from the first day after the expiration of the original term of cooperation.

The duration for a cooperative joint venture shall not be extended if the joint venture contract has allowed the Foreign party to first recover its investment and such investment has been fully recovered. However, when the Foreign party of a cooperative joint venture agrees to increase the investment and when all parties reach consensus after consultation, an application for extension of the term of cooperation may be filed with the examination and approval authority in light of paragraph II of this Article.

Article 48 A cooperative joint venture shall be dissolved in one of the following situations:

(1) Termination of duration;

(2) Inability to continue operations due to have financial losses of the cooperative joint venture or heavy losses caused by force majeure;

(3) Inability to continue operations due to the failure of one or several parties to fulfil the obligations as stipulated in the contract and articles of association;

(4) Occurrence of other reasons for dissolution stipulated in the contract and articles of association;

(5) Revocation made by authorities according to law due to violation of laws and administrative regulations. In cases described in (2) and (4) of this Article, the board of directors or joint management committee of a cooperative joint venture shall make the decision and submit it to the examination and approval authority for approval. In case of (3) of this Article, the party or parties failing to fulfil obligations as stipulated in the contract and articles of association shall be held liable to losses thus occurred to party or parties fulfilling the stipulated obligations. The party or parties that have fulfilled their obligations have the rights to apply to examination and approval authority for the dissolution of the cooperative joint venture.

Article 49 The liquidation procedures of a cooperative joint venture shall be handled according to relevant Chinese laws, administrative regulations and stipulations in the joint venture contract and articles of association.

Chapter IX Special Provisions on Cooperative Joint Ventures without Legal Person Status

Article 50 A cooperative joint venture without legal person status and all parties to the venture shall be held responsible for civil liabilities according to relevant provisions in Chinese civil laws.

Article 51 A cooperative joint venture without legal person status shall register the investment made or cooperation conditions provided by each party at the administrative authority for industry and commerce.

Article 52 The investment made or cooperation conditions provided by each party to a cooperative joint venture without legal person status shall belong to the contributing party. Depending on agreements reached by all parties, such investment or cooperation conditions may be jointly owned by all parties, or partly owned by each contributing party and partly owned by all parties. Assets accumulated from operations of the cooperative joint venture shall belong to all parties.

Investment made or cooperation conditions provided by parties to a cooperative joint venture without legal person status shall be subject to unified management and utilisation by the cooperative venture. No party shall take the liberty to take actions on such matters without the consent from other parties.

Article 53 A cooperative joint venture without legal person status shall establish a joint management committee which shall consist of representatives of all parties to the cooperative joint venture and shall manage the cooperative joint venture on behalf of all parties.

The joint management committee shall decide on all major issues concerning the cooperative joint venture.

Article 54 A cooperative joint venture without legal person status shall establish unified account books on the location of the joint venture, and each party to the joint venture shall establish its own account books.

Chapter X Supplementary Provisions

Article 55 Chinese laws shall be applied in the conclusion, effectiveness, interpretation, execution of the contract and settlement of disputes of a cooperative joint venture.

Article 56 Provisions in other relevant laws and administrative regulations shall apply to matters other than those provided for in the Detailed Rules, including financial affairs, accounting and auditing, foreign exchange, taxation, labour management and trade union etc. concerning a cooperative joint venture.

Article 57 Where a cooperative joint venture is established by a company, enterprise, other economic organisation or individuals in Hong Kong, Macao and Taiwan region and Chinese citizens inhabited abroad, it shall be handled with reference to these Detailed Rules.

Article 58 These Detailed Rules shall enter into force as of the date of promulgation.

Appendix 6.14

Explanations on Implementing Certain Articles of Detailed Rules on the Implementation of the Law of the People's Republic of China on Sino-Foreign Joint Cooperative Ventures

(Promulgated by the Ministry of Foreign Trade and Economic Cooperation on October 22, 1996)

Detailed Rules on the Implementation of the Law of the People's Republic of China on Sino-Foreign Joint Cooperative Ventures (hereinafter referred to as the Detailed Rules) was promulgated and enforced on September 4, 1995. Now, explanations concerning the implementation of the Detailed Rules are hereby made as follows:

1. Article 14 of the Detailed Rules stipulates:

"Joint ventures with Chinese legal person status shall be limited liability companies. The partners shall share responsibilities within the limit of its investment or cooperative means rendered, unless otherwise stipulated under the contracts.

The joint venture shall have liability for its debts with all of its capital."

The explanations: In accordance with the Section 1 of the present article and Article 18 of the Law of Corporation of the People's Republic of China, the organisational form of any joint cooperative ventures with Chinese legal person status which have been set up after the approval shall be limited liability companies.

2. Article 18 of the Detailed Rules stipulates:

"The partners' investment or cooperative means could be currencies, or material objects or industrial rights, special technologies, land use rights and other property rights.

The Chinese partners' investments or cooperative means, if they are State fixed assets, shall undergo assets assessment in accordance with related laws and administrative regulations or provisions.

For joint ventures with Chinese legal person status, the foreign partners' investment shall normally be no less than 25% of the total registered capital of the joint venture. For joint ventures without Chinese legal person status, the specific requirements for the partners' investments or rendition of cooperative means shall be stipulated by MOFTEC."

The explanations: The investment, as mentioned in Section 1 of this article, refers to currencies, buildings, machinery and equipment or other materials, industrial property rights, special technologies, land use right and others which are assigned a fixed price and used as the investment of partners.

The cooperative means, as mentioned in Section 1 of this article, refers to the real estate and other property rights, including: land use right, ownership or right of use concerning the buildings constructed on the land and other fixed accessory equipment attached to the buildings, industrial property rights, special technologies and other property rights. The cooperative means rendered by partners to the joint cooperative ventures belong to the property of joint cooperative ventures. The said means shall not be expressed in the form of currencies, but shall be registered as subsidiary and have liability for the debts of the joint cooperative ventures.

The Chinese partners' investment and cooperative means shall undergo assessment, if they are required to do so in accordance with the stipulations of relevant laws and administrative regulations. The assessment results shall be the basis for the negotiations for cooperation, so as to prevent the loss of the state property.

For joint cooperative ventures without Chinese legal person statures, the foreign partners' investment shall be no less than 25% of the total investment made by the Chinese and foreign partners.

3. Article 44 of the Detailed Rules stipulates:

"When the operation term as set in the joint venture's contract expires, if the joint venture's fixed assets have been set to be handed to the Chinese partners free of charge, the foreign partners can, during the operative term, apply to recover their investment in the following manners:

(1) Aside from the distribution in accordance with the investment and/or cooperative means rendered, the foreign partner can increase its share in the distribution in the contract;

(2) With the examination and approval of the finance and taxation authorities in accordance with related taxation regulations, the foreign partners recover their investment before the joint venture pays its income tax;

(3) Other investment recovery measures approved by the examination and approval departments and finance and taxation departments.

When the foreign partners recover investment during the operation term as described in the previous paragraphs, the Chinese and foreign partners shall shoulder the joint ventures' debts in accordance with provisions of related laws as well as the ventures' contracts."

The explanations: The fixed assets of joint cooperative ventures, as mentioned in Section 1 of this article, refer to the fixed assets out of the remaining assets after the joint cooperative venture liquidates its assets, financial claims and debts and pays its debts in accordance with the stipulations under Article 24 of the Law of the People's

Republic of China on Chinese-Foreign Contractual Joint Ventures. Before the joint cooperative venture pays off after liquidation and discharges its debts, the Chinese partner shall not distribute in advance the fixed assets of the joint cooperative venture even when the operation term of the venture expires.

Item 3 of Section 1 in this article means that, with the approval by the finance and taxation departments and the examination and approval departments, foreign partners are allowed to recover their investment in advance during the operation term through means of distributing depreciation costs of the fixed assets of the joint cooperative venture. In case the assets of joint cooperative venture decrease as a result of foreign partner's distribution of depreciation costs of the venture's fixed assets, the foreign partners must submit letters of guarantee with the amount equivalent to the aforesaid distribution of depreciation costs, presented by banks or financial institutions within the territory of China (including those branch banks or affiliated agencies established within the territory of China by overseas banks or overseas financial institutions) so as to guarantee that the joint cooperative venture has the debt paying ability.

Procedures of application and approval:

In case the joint cooperative venture's contract stipulates before the establishment of the venture that foreign partners adopt the investment recovery measures as described in Item 3 of Section 1, Article 44 of the Detailed Rules, the Chinese partner shall first file an application to the financial organization with the aforesaid letters of guarantee in accordance with the procedures. With the examination of and approval by the financial organization, the application shall then be filed to the examining and approving departments for examination and approval in line with Article 7 of the Detailed Rules.

During the term of business operation of the joint cooperative venture, in case foreign partners intend to recover their investment in advance through the means as stipulated in Item 3, Section 1 of the said article, the joint cooperative venture shall file an application to the examining and approving departments with the aforesaid letters of guarantee in accordance with the procedures. The examination and approval departments shall decide jointly with financial organizations whether or not to grant approval within 60 days of receiving the aforesaid documents.

In case a joint cooperative venture needs to accelerate the depreciation of the fixed assets so as to ensure the foreign partners to recover their investment in advance, the joint cooperative venture, in addition to abiding by the regulations as stipulated in the previous section, shall gain the approval by the State Administration of Taxation in accordance with the relevant regulations of Detailed Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises.

"The examining and approving authorities" as mentioned in the present Explanations refers to the Ministry of Foreign Trade and Economic Cooperation or departments and provincial governments (departments in charge of foreign trade and economic cooperation) authorised by the State Council.

"The finance and taxation authorities" refers to the financial organisations and taxation authorities at the same level of the above-mentioned examining and approving departments.

Appendix 8.1

Report on the Outline of the Tenth Five-Year Plan for National Economic and Social Development (I)

(Delivered at the Fourth Session of the Ninth National People's Congress on March 5, 2001)

Zhu Rongji
Premier of the State Council

Fellow Deputies,

Beginning this year, China will implement the first five-year plan for the new century. The Proposal of the CPC Central Committee for the Formulation of the Tenth Five-Year Plan for National Economic and Social Development was adopted at the Fifth Plenary Session of the Fifteenth CPC Central Committee. The Proposal defined objectives, guiding principles and major tasks for China's economic and social development during the next five years. In the spirit of the Proposal and on the basis of opinions solicited from all sectors of society, the State Council has drawn up the Outline of the Tenth Five-Year Plan for National Economic and Social Development (Draft). On behalf of the State Council, I now make my report to you and present the Outline (Draft) for your consideration and also for comments from members of the National Committee of the Chinese People's Political Consultative Conference.

I. Review of National Economic and Social Development

During the Ninth Five-Year Plan Period

Over the past five years, the people of all ethnic groups worked hard together, blazed new trails with a pioneering spirit, and obtained great achievements in all fields of endeavour under the leadership of the Communist Party of China.

The national economy experienced sustained, rapid and sound development, and overall national strength continued to grow. In the five years, China's GDP increased by an average annual rate of 8.3% and reached 8.9404 trillion yuan in 2000. The mission of quadrupling the per capita GNP of 1980 has been overfulfilled. As the economy continued to grow and economic performance improved, national revenue in 2000 reached 1.338 trillion yuan, an average increase of 16.5% annually. The output of major industrial and agricultural products now stands in the front ranks of the world's economies, and commodity shortages were by and large eliminated. Progress was made in industrial restructuring. The quantities of grain and other major agricultural products we are capable of producing increased noticeably, marking a historic change from a long-term shortage of agricultural products to a basic balance in their total supply and demand, with even a surplus during good harvest years. Good results were achieved in eliminating outmoded industrial production capacity, reducing excess production capacity and upgrading technology in key enterprises. Information technology and other new and high-tech industries grew rapidly. Marked success was achieved in infrastructure development, alleviating bottlenecks in energy, transportation, communication, and raw and processed materials.

Economic restructuring was extensively carried forward, and a socialist market economy was preliminarily established. Significant advances were made in the establishment of a modern corporate structure in large and medium-sized state-owned enterprises. Most key state enterprises became corporations, and a considerable number of them were listed on stock markets inside or outside China. There was a marked reduction of losses and increase of profits in enterprises, and total profits from state-owned industrial enterprises and from the industrial enterprises with a controlling share held by the state reached 239.2 billion yuan in 2000, an increase of 190% over the 1997 figure. The objectives of reforming large and medium-sized state-owned enterprises and turning around loss-generating operations within three years were basically attained. At the same time that public sectors of the economy further developed, private and individual sectors also grew rapidly. The market system continued to improve, and the supply of capital, technology and labour expanded rapidly. The basic role of the market in the allocation of resources was noticeably enhanced. The system of finance and taxation continued to improve. Banking reform was accelerated. Major progress was made in the reform of the urban housing system, the social security system and government institutions. The state macro-regulation system was further strengthened.

We opened wider to the outside world, and the pattern of all-round opening took basic shape. Reform of the foreign trade system steadily progressed, and the internationally-oriented economy grew rapidly. The total volume of China's imports and exports reached US$474.3 billion in 2000, with exports accounting for US$249.2 billion, a rise of 69% and 67% respectively over the 1995 figures. The mix of exports improved, and the proportion of electromechanical products and high-tech products increased. The spheres of activity open to foreign businesses were gradually widened, and the investment environment was improved. Foreign investment was increased and better utilised. More than US$289.4 billion in foreign funds were put to use during the past five years, an increase of 79.6% over the period of the Eighth Five-Year Plan. China's foreign exchange reserves totalled US$165.6 billion at the end of 2000, US$92 billion more than in 1995.

People's living standards continued to improve, and generally people began to lead a relatively comfortable life. In 2000 the per capita net income of rural dwellers and the per capita disposable income of urban residents reached 2,253 yuan and 6,280 yuan respectively, increasing by 4.7% and 5.7% annually in real terms. There was abundant supply of commodities; the level of consumption continued to rise, and the total volume of retail sales of consumer goods increased by an average annual rate of 10.6%. Housing, telecommunications, electricity and other aspects of living conditions for both urban and rural residents improved considerably. Personal savings deposits of residents increased by more than 100% over the past five years. The value of stocks, bonds and other financial assets increased rapidly. The number of people below the poverty line in rural areas decreased drastically. The objectives set in the seven-year plan to help 80 million people get out of poverty were basically attained.

The development of science, technology and education was accelerated, and other social undertakings progressed in a comprehensive way. The March 1986 Program to stimulate the development of high technologies was implemented successfully. A number of major results were achieved in the fields of aeronautics and astronautics, information technology, materials science, bioengineering and other high technologies. New advances were made in basic and applied research. The transformation of applied research institutes under government departments into enterprises has been basically accomplished, and restructuring of other research institutes has been carried out in a comprehensive way. The process of getting scientific and technological achievements to the market and applying them in production was accelerated. Progress was made in strengthening various types of education at all levels. Initial success was achieved in fulfilling the objectives of making nine-year compulsory education basically universal in the country and eliminating illiteracy among young and middle-aged people. Major progress was made in the reform of the management system of higher education. The increase of university and college enrolment was widely appreciated by the general public. New advances were made in population management and family planning. Great efforts were made in ecological conservation and environmental protection. Culture, public health, sports and other social undertakings continued to develop. Successive results were achieved in building a clean and honest government and in the struggle against corruption. The administration of all facets of public security was improved. New progress was made in improving socialist spiritual civilisation, democracy and the legal system. Continuing progress was made in modernising national defence and the armed services.

During the Ninth Five-Year Plan period, the Chinese government resumed its exercise of sovereignty over Hong Kong and Macao, and historic progress was made in the great cause of peaceful reunification of the motherland. Since the return of Hong Kong and Macao to the embrace of the motherland, the principle of "one country, two systems" and the basic laws of the two regions have been implemented in a comprehensive way. Outstanding achievements were made in the work of the governments of the special administrative regions. Social stability and economic development were secured in Hong Kong and Macao.

With the fulfilment of the Ninth Five-Year Plan, we attained the strategic objectives for the second stage of China's modernisation drive, which laid a solid foundation for undertaking the Tenth Five-Year Plan and moving on to the third stage. This constituted a great achievement in China's socialist modernisation drive and a new milestone in the progress of the Chinese nation.

These tremendous achievements in economic and social development during the Ninth Five-Year Plan period were hard-won victories over numerous difficulties. We successfully coped with the challenges posed by unexpected international events. We protected ourselves from the impact of the Asian financial crisis. We controlled inflation during the initial stage of the Ninth Five-Year Plan and curbed deflation in the middle and late stages. We also conquered severe floods and droughts. We attained these achievements thanks to the timely and correct policy decisions made by the CPC Central Committee with Comrade Jiang Zemin at its core in the face of numerous problems and difficulties and to the concerted efforts of the people throughout the country. On behalf of the State Council, I would now like to pay my highest respects to the people of all ethnic groups. You have all been working hard and making contributions in your own fields of endeavour. I also wish to express our sincere thanks to our compatriots in Hong Kong Special Administrative Region, Macao Special Administrative Region, Taiwan, as well as to overseas Chinese who have shown their concern and support for the development and reunification of the country.

During the implementation of the Ninth Five-Year Plan, we have accumulated a wealth of experience in improving macro-economic management and regulation to meet the requirements for developing a socialist market economy.

First, we have solved problems blocking our advance by stimulating economic development. Development is the fundamental principle. In the face of various social problems, we have always made economic development the central task and adopted effective measures to promote a sustained, rapid and sound development of the national economy, thus providing a foundation for handling other problems properly.

Meanwhile, we adhered to the principle of "doing two jobs at once and attaching equal importance to each". We increased our efforts to improve socialist spiritual civilisation, democracy and the legal system, and this has created a good political and social environment and provided a strong impetus for economic development.

Second, we made timely adjustments to the macro-control policy in accordance with the changing economic situation. In dealing with inflation, we paid attention to ensuring sustained expansion of the economy and a successful "soft-landing". In curbing deflation, we adhered to the principle of boosting domestic demand, resolutely enforced a proactive fiscal policy, and improved various policies and measures in the course of experience. We issued additional national bonds and expanded investment on the one hand, and we appropriately increased the income of the medium- and low-income urban residents and encouraged more consumption on the other, thus stimulating economic growth. We also adopted such measures as raising the export tax rebate rate and cracking down on smuggling in order to expand exports, achieve a balance of international payments, and keep the value of RMB stable. We implemented prudent monetary policies, adjusted interest rates and adopted many other measures to support economic growth. At the same time, we regulated the monetary supply, guided the direction of credit, and guarded against and reduced financial risks.

Third, we integrated the expansion of domestic demand with economic restructuring. In view of the over-productivity in the general processing industries, investments from national bonds were mainly put into infrastructure development. Investment in agriculture, science, technology and education was also increased, and support was rendered for technological upgrading in enterprises. We made use of the surplus production capacity in the capital goods industry to accomplish some large undertakings we had been wanting to but were unable to do for years. By so doing, we stimulated economic growth and increased the stamina for further economic development.

Fourth, we balanced reform, development and stability. Under complicated and difficult conditions, instead of coming to a halt, reform pressed forward vigorously and in an orderly manner, giving a powerful impetus to economic development. In the meantime, attention was paid to adjusting the magnitude of reform to the tolerance of the people. When economic restructuring and deepening reform unavoidably touched deep-seated interests, great attention was paid and various policies and measures were adopted to safeguard the fundamental interests of the general public. Vigorous efforts were made to implement re-employment projects and ensure that laid-off workers receive their basic living expenses and retirees their old-age pension payment on time and in full. The farmers' surplus grains were purchased without restriction at a protective price. All these measures helped to safeguard social stability and achieve sustained economic growth.

While fully affirming our achievements, we are clearly aware that there are still numerous problems in our economic and social life. The principal problems are as follows: inappropriate industrial structure and non-co-ordinated development of local economies; low overall quality of the national economy and low competitiveness in the international market; imperfections in the socialist market economy and conspicuous systematic factors hampering the development of productive forces; a comparatively backward state of science, technology and education, and relatively weak innovative ability in science and technology; a shortage of important resources such as water and petroleum and the deterioration of the ecological environment in some regions; growing employment pressure, slow income increase of farmers and some urban residents, and an increasing income gap; considerable disorder in some areas of the market economy; frequent occurrences of grave accidents; serious corruption, extravagance and waste, formalism and bureaucratism; and poor public order in some localities. The causes for these problems are rather complicated, but they are not unrelated to shortcomings and errors in our work. We must pay great attention to them and take further steps to solve them.

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